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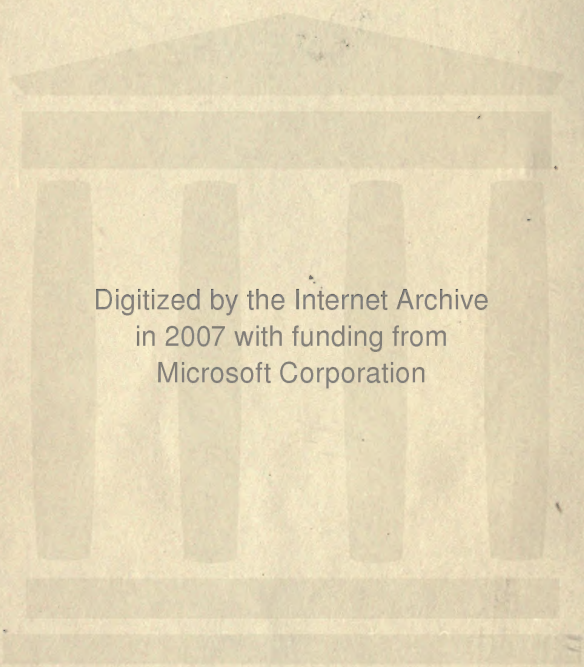

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MONEY AND CREDIT

by

C. J. MELROSE

Author of 'THE DATA OF ECONOMICS,' etc.

WITH AN INTRODUCTION BY

PROFESSOR IRVING FISHER

Yale University

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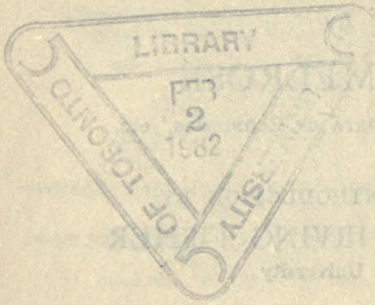

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AUTHOR'S NOTE

THE following by Professor Irving Fisher was intended to be a Foreword to a collection of articles which I had contributed to various journals in the course of some years, which I thought of having published in book form. But in his letter to me, the Professor suggested that I should be doing the subject greater justice if I wrote it anew in orderly and connected sequence, rather than present it in the scrappy and fragmentary form inevitable to periodic contributions. I agreed with him; and this book is the result. The views herein expressed being identical with those given in the various articles, I feel justified in publishing his Foreword without express permission, consequent on the change of form.

I do not know whether I ought to describe this book as intended to be Elementary or Intermediary. At any rate, it does not pretend to be exhaustive, but only to set

students on the road to further investigation. Yet, in place of the conventional apology and mock humility, I prefer to say frankly that I believe I am making an important addition to the elucidation of this difficult subject—at any rate, in my analysis of the muddle-headed conception of 'Credit.' The time is opportune. The world's currency, as well as its social and political structures, is in the melting pot. Now, if ever, is the time for a reconstruction of the chaotic currency systems of all nations. The need is distinctly pressing.

C. J. M.

FOREWORD

I TAKE pleasure in acceding to the request to write a short Foreword to this excellent little book of Mr Melrose's.

After every great convulsion of prices the world stands bewildered. At once a great mass of literature springs into existence, attempting to explain what has happened. Unfortunately, many writers rush into print who have not really penetrated beneath the surface of their subject. The 'explanations' of these authors merely make confusion worse confounded. Wherever, therefore, a writer does not becloud his subject, but, instead, casts real light upon it, he certainly deserves the thoughtful attention of the public.

I do not mean, of course, to endorse specifically every point of view of Mr Melrose. But I do most heartily welcome his book as a useful addition to our literature and one which has the rare merit of being both substantial and simple.

In a democracy science cannot be altogether esoteric. It must be, to a large extent, popular. Mr Melrose's book is popular science in its best sense. It is only as great masses of the general public comprehend what has happened that any real solution of our currency difficulties can ever be found.

What is needed, as Mr Melrose has pointed out, is *stability* of the price level. The problem, therefore, can never be solved until we have some form of stabilisation, and we can never have stabilisation, under a democratic form of government, until there exists a general understanding of wherein instability consists. It should be known by every intelligent person that the instability lies in money and credit and that we should therefore stabilise money and credit.

Until there is some more general realisation of the existence of instability in the purchasing power of our monetary units, and some more intelligent comprehension of its nature, those who are in the position to initiate action in such matters will continue to shirk their task, both because they feel

that it is impossible to secure any practical action and because they cannot resist the temptation to follow the line of least resistance. The line of least resistance is to blink the facts and to condone the evils. As long as they have such feelings, those who might take the lead will, instead, discourage proposals for any change whatever in our present chaotic situation, lest the admission that something is wrong should let loose some remedy worse than the disease.

It follows that really to work our way out of the maze we must pursue patiently and steadily a great and perhaps a long-drawn-out campaign of education. In this campaign Mr Melrose's book should take a high place.

IRVING FISHER.

YALE UNIVERSITY,
April, 1921.

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CHAPTER I

CHAPTER I

I.—INTRODUCTORY REMARKS

'THE economist often has to say things that appear so simple and commonplace as not to be worth saying. The reason is that extremely important consequences follow from these commonplace truths, and, since the truths are overlooked because they are commonplace, the consequences that follow from them may also be disregarded, and with fatal results.'

I quote this extremely apt 'commonplace truth' from *Wealth and Work*, by George W. Gough, M.A. (p. 75), as fitting preface to much of what I shall have to say. There is only one correction I should like to make in it. In place of 'may also be' I should like to say 'are.' It is really astounding how much of what appear to the trained reasoner obvious truisms are frequently

misconceived, ' and with fatal results.' That is particularly so in the case of economics generally, and supremely so in the case of the science of ' Money and Credit.'

The reason is that for untold generations, ever since money in some form became a firmly established institution, the human mind had been attuned to seeing a topsy-turvy image of the economic reality. Money had become invested with a creative faculty inferior only to that of the Deity. In place of seeing the economic structure as an aggregation of humans co-operating in the production of things, and of rendering services, capable of satisfying human needs and desires, money being the intermediary, or go-between, whereby the things and services are exchanged one for the other, it is conceived as a world engaged in grinding out money. Men labour and sweat in field, factory, or mine, in mill, office, or counting house, in order to get money. It is the money that creates things.

I take it that few of the reading public would fail to subscribe readily to the formula that ' money is the medium of exchange ';

yet the consequences that follow from this commonplace truth are not only disregarded, but, with few exceptions, remain utterly unrealised. Even where consciously the consequences are given a grudging admission, the sub-conscious impression had become too deeply ingrained to be eradicated by the mere repetition of a formula. Convinced against their will, they remain of the same opinion still. Get them to yield on one point, you will soon find that the old impression breaks out in a new spot.

By common consent, the subject of money, or currency, is the most difficult and obscure in the whole range of Economic Science. Personally, I do not think the subject is inherently difficult or obscure, as I trust to convince the reasoning reader who follows me to the end of my exposition, incomplete as it may be. It has been made difficult and obscure mainly (1) by the inherited mental state above referred to, and (2) by the experience gained from childhood on of the purchasing power of money; but also by the enormous amount of error and

fantastic notions which have been published on the subject. I think that more cranky notions have been uttered and written on currency than on any other subject under the sun.

The writer on currency, therefore, if he is to convince his readers and to succeed in eradicating the sub-conscious impression must not only be prepared to state commonplace truths, but must present his points times and again from different angles, clothed in different verbal garbs, and with varying images and illustrations. Necessarily, he has his own view points, and cannot hope to escape controversy. All the more reason why he should not sacrifice any telling argument for fear of repetition in substance. Though I cannot exhaust the subject, I trust that I shall state my case clearly and convincingly, without being tedious; and that I shall have aroused the interest of my readers to induce them to study the subject further, and to join forces with others in effecting necessary changes. The world's currency systems have changed many times; and we have now reached a

period in economic evolution when a thorough overhauling in the light of modern knowledge and rationality has become imperative. At present, they are in a state of hopeless chaos.

2.—ECONOMIC EVOLUTION

Primitive man starts his human career as his own universal provider—and a very scanty and precarious provision it proves to be. He captures what prey he can with the aid of a jagged stone or roughly-shaped club, digs up roots with his hands or with the aid of a pointed stick, gathers wild fruit and perhaps some edible vegetation, and takes shelter from the elements and wild beasts in branches of trees or in natural caves. When later he acquires the art of chipping flint to a fine edge, he obtains a considerably wider mastery over the surrounding natural objects. In course of time he provides himself with some roughly-shaped stone and wooden utensils; he learns to plait grasses, reeds, and pliable bark of trees into mats, baskets, ornaments, and

some personal coverings; later he learns to hollow out logs into canoes, and to capture some fish with the aid of sharpened sticks, which he uses as spears. Later still, his spears are tipped with sharpened flint heads, and he becomes a mighty hunter. He learns to clean and dry animal skins; to stalk his prey; and to snare them by digging pits which he artfully covers up with leafy branches of trees. As a final triumph, he learns to domesticate certain animals, and his career of prosperity begins in earnest. The art of making artificial fire is discovered; and from that moment on he is firmly set on his human career.

Many ages go by before the art of agriculture is discovered. The burning up of a patch of cereal-yielding grasses manures the ground, with the result that the next crop is visibly larger and more robust. A time comes when some native genius is struck with the idea that these grasses are capable of cultivation and improvement. His experiments meet with various degrees of success. He discovers that water is essential to the growth of vegetation. By

infinitely slow degrees the art of agriculture is developed—a process which is far from completed even to this day. With the domestication and breeding of animals and the development of agriculture dawns the era of economic and social progress. Without these, man must have remained the primitive savage that he was.

3.—'SURPLUS PRODUCT' AND 'SURPLUS WEALTH'

Long before economic advance had passed the stages outlined above—probably while hunting was yet man's chief means of subsistence—he had ceased to be a completely self-contained economic unit. He had learned to barter the product of his labour for the products of the labour of others. Now, barter manifestly necessitates that a man should be producing more of a given commodity than he needs or intends to consume himself—what we should now call 'producing a surplus.' But the term 'surplus' is used in two different senses; and since we shall have to employ the term

frequently, we must make sure that the sense in which it is used in each particular case shall be clearly understood.

A farmer, *e.g.*, produces more foodstuffs than he needs to consume. The 'surplus' is intended for sale—that is to say, in economic reality, to be exchanged for other things which he needs or desires. Now, in that sense of the term 'surplus,' all workers under modern conditions produce large surpluses—indeed, in most cases, the products are surpluses to within an insignificant fraction of the total, and in some cases they are wholly surpluses to the very last ounce. Thus, *e.g.*, the producer of marine compasses may never use a marine compass, not even to the extent of availing himself of the navigation which the compass is designed to aid. But even in such staple products as boots, cottons, and woollens, the producer himself consumes no more than a tiny fraction of his product, whether he works for wages or for what is called 'profits.' The rest is intended to be exchanged with other producers for many other things and services.

We will suppose that the farmer spends during the year the whole of the money for which he sold his surplus products—in other words, he consumes in many things the full equivalent of what he has produced. In that case, the term 'surplus' cannot be understood as anything 'left over.' It is just the quantum which, under division of occupations, he produces to exchange with others, so that each may supply some of the other's needs, thus obtaining by co-operation more of things than they could have obtained by each providing wholly for himself.

We will now suppose that, instead of consuming the full equivalent of what he has produced, the farmer (1) stores away some cereals as a standby in case of some future shortage, or (2) that he does not spend the whole of the money for which he sold his products, keeping the money as a standby. He has now produced a 'surplus' in the real sense of something 'left over.' In the case of the farmer having saved the money, the actual surplus is in the market to be consumed by others, in

return for which he holds a claim on future production. We shall have occasion to elaborate this aspect of the matter much further in the course of our investigation.

Wherever, therefore, the context does not show quite clearly in which of these two senses the term 'surplus' is to be understood, I propose to distinguish between them by calling the mere excess of particular commodities which are exchanged and consumed 'surplus products'; while the true surplus, in the case where the producer consumes less than the equivalent of what he has produced, I shall call 'surplus wealth.' In most cases the meaning will be clear from the context.

4.—DIFFICULTIES OF BARTER

In the initial stage, barter takes place only occasionally, and is confined to just odds and ends produced as a hobby in spare time, like the 'swopping' indulged in by most boys. Man still relies upon his own efforts for the provision of his staple needs. So long as each individual who

has something to barter has to make the round of the village or tribe to find some one who needs what he has to dispose of, and who is able and willing to give him something that he desires in exchange for it, granted that the things swopped are esteemed to be a fair exchange, the process is necessarily both laborious and difficult. But in course of time men hit upon the idea of instituting 'market' days, held on some chosen spot, both tribal and, later, inter-tribal, where many people meet together, and with much haggling, noise, and argument agree upon the terms of each individual act of barter. With the institution of markets, barter is much facilitated; and the consequence is that specialisation of occupations gradually sets in and grows apace. One who happens to be particularly skilful, *e.g.*, in chipping flints to fine points and edges, finds it more advantageous to devote his whole time to making arrow-heads and flint knives, and to barter them for whatever else he wants, rather than divide his time between, say, hunting and arrow-head making. With the spread of

specialisation, there comes an enormous increase in producing capacity, both by increased skill and by the economising of time wasted in shifting from one occupation to another.

With specialisation and increasing production, barter becomes continuously more difficult. The difficulties of barter are so plainly manifest, and have so frequently been depicted by writers on economics, that I will take my readers' appreciation of them for granted. Some other method had to be found; but there are only two possible alternatives. It is either: 'I give you this and take that,' or it is 'I give you this to-day and will demand the return of an agreed-upon equivalent some other day.' There is positively no possible third alternative. It is either a 'swop,' or it is a 'credit.' Thus the hunter will give up a skin to the farmer, stipulating for the return, probably by instalments, of some definitely named farm products. The 'direct' barter gives place to 'deferred' barter. I here ask the reader to bear in mind the apparent truism that it is the

hunter who holds a 'credit,' and the farmer who has a 'debit'—that it is sheer perversion to say that the borrower had got credit, when in actual fact it is the exact opposite. As we go along we shall find that this reminder is by no means superfluous.

5.—THE NOTCHED STICK AS MONEY

But some instrument or token had presently to be devised to keep record of such credits. The earliest record of the kind was a notch made on a stick. When this sort of record became familiar, it sometimes happened that the holder of the credit token wanted something different from that stipulated to be returned by the debtor. So he offered to transfer the credit to some one who could give him the thing he wanted, and was willing to take in exchange that which the debtor had agreed to give in return. When such transfers of credits came to be frequently repeated, and gradually developed into a common habit, the notched stick in effect functioned as money. We have it on record that the

notched stick was in fact the earliest form of money.

We have, however, to realise that an instrument used more or less frequently to transfer credits from one person to another is not quite 'money' in the sense that we understand it now, and would not facilitate production to the extent that we expect from it to-day. Before the instrument can function in a real sense as money, the honouring of the claim for which it stands must not be open to doubt, and it must have become 'impersonal.' Thus, A having a credit on B might transfer it to C, who would demand the return from B. The exchange would then be 'triangular'; but that would not get rid of the difficulties of barter to any considerable extent. Neither A nor C may be in immediate need of what B can give up; or the thing which A wants to get from C may be of higher exchange value than that which B had agreed to give up.

6.—THE FOUR STAGES OF BARTER

Before an instrument of credit transference can effectively function as money, it must have become so familiar and reliable that it would be accepted by any one in what is called 'payment' for any surplus he has to dispose of; in full confidence that he will, in his turn, get what he wants by tendering it in payment to some one else. Of course, the real 'payment' only comes when the acceptor of the instrument changes it for what he wants to consume himself; using the term 'consumption' in the economic sense of usage in any form. That escapes the immense difficulty of barter which necessitates the meeting of two people who are mutually in need of each other's products, and of those products being of equal exchange values. By means of the commonly accepted 'medium,' the seller of things of small value can accumulate units of money from many buyers until he has sufficient to equal the thing of higher value which he needs. Thus we get four

progressive stages of barter: from 'direct' to 'deferred,' from that to 'triangular,' and finally to 'roundabout.'

Professor Irving Fisher tells of a town in America (I am quoting from memory) where, not so many years ago, certain tram-car checks were commonly used as small change. Of course, they had no sort of legal validity, except that the car company could, I suppose, be sued if they refused to honour their own checks. The acceptor of these checks might have no need to travel by car; but he knew that thousands did, and that they would be willing to take them in payment for small purchases or in change. This shows that 'acceptability' is the principal condition of the functioning of money, no matter what substance it consists of.

If I may be allowed a figure of speech, I would say that barter is nature's method of exchanging; and that all exchanges, however complicated the mechanism, must have true barter as the ultimate source. We must fix this truth firmly in our minds if we are to have a true grasp of the problem

of money and exchanges. When money does not stand ultimately for barter, it is either a tax or a fraud, whether or not it is legally punishable.

Of course, exchanges are not confined to that of tangible things, but also of services. Indeed, man produces nothing at all in the real sense; nature alone does the producing. All that man can do is to extract what nature yields; mix, adapt, shape, mould, and transport the materials which nature provides. One man guides the plough, another follows with a basket and scatters seed in the furrow, and a third walks to and from the field and barn, refilling the baskets as they are emptied. Which of them does the producing? And why either of them more than the horse? Since, however, the notion that the man who makes toothpicks is a producer while the man who navigates an ocean greyhound is only rendering service is so universal and deeply ingrained, I had better not risk causing confusion of thought by discarding the term 'production'; and must be satisfied with warning my readers that there is

no real economic distinction between so-called production and that of rendering services. I think this warning will be sufficient to guard the reader from misconception.

The upshot is, that money creates nothing, and neither does man in any real sense; but that men render services to each other, and money is the medium, or go-between, whereby these services are exchanged. The misfortune is that, so far, man has yet failed to provide an exchange medium which does not frequently go wrong. As evidence of human incapacity, blundering, and chicanery, the history of money provides a plentiful crop. With few striking exceptions, the orthodox teachers of Economics have pinned their faith to the 'gold standard'; but this standard has manifestly gone wrong with the rest. Is this blundering to continue *ad infinitum*? This is the subject matter of our investigation.

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7.—A UNIT OF COMPUTATION

The institution of money brought about another change of immense importance. At the outset, the notch was simply a private reminder, signifying something different to each holder. Thus, to the hunter it may have stood as a record that the farmer owed him a measure of corn ; and to the farmer it may have meant that the hunter owed him so much meat, or a skin. But before the credit represented by the notched stick could be transferred from hand to hand, an understanding must have been arrived at that a notch made in a particular way shall stand uniformly for some recognised unit of a well-known commodity—generally the one most highly esteemed by the tribe. Suppose the notch to have stood for a given measure of wheat; then, if two measures of barley commonly exchanged for one of wheat, the stick would buy either one measure of wheat or two of barley. In other words, the measure of wheat became the Unit of Computation. When the notched

stick became the accepted money unit, then instead of standing for some one specific object it functioned as a unit of value for the purchase or sale of anything; but computed, nevertheless, by some recognised commodity unit. This point we shall have to elaborate further as we proceed.

8.—COMMODITY MONEY

A time came, however, when the greed of gain conquered the instinctive honesty of the unsophisticated tribesmen. The notched stick money was so easily counterfeited; and when once the rot set in the ancient world found itself impotent to devise a mere token that could not be easily imitated. At a later period, the money of Carthage consisted of leather discs in which something was sewn up, though no one knew what it was—an astute confidence trick on the part of the then Chancellor of the Exchequer —but that had to go the way of the notched stick. So man was driven to employ Commodity Money, of which nature limits the supply. Then, unless an imitation of

inferior quality could be put in circulation without easy detection, there could be no gain in issuing unauthorised money, since its purchasing capacity was supposed to be neither more nor less than its commodity value. They failed to realise that nature's fluctuations in supply would upset their calculations—assuming there were any calculations. As a matter of fact, all of the early forms of money got into acceptance and circulation by sheer force of circumstances, without the least design on any one's part, and they got out of circulation exactly in the same way—when it was found that they had ceased to function efficiently. At a certain stage of human progress, man is almost utterly helpless without money in some form; so, if he cannot have the best, he will take the best he can, bad as it may be. In this way cowrie shells became money, until a too plentiful supply destroyed their purchasing capacity; as is very nearly the case with the Russian Rouble and the Polish Mark to-day. Many substances served as currency —some forty-six of them are known—until

finally it settled on the two metals, silver and gold. The latter has now been adopted as the standard by the more progressive Western nations.

9.—A MIXED CURRENCY

But, with the increase in producing capacity and the volume of exchanges, much of it international, the use of gold as the sole money (bar small change) became increasingly more burdensome, and finally impossible. In the first place there was not enough of it in the world to meet the volume of exchanges, and of what there was much was being hoarded. For another thing, it is far too expensive. Its high commodity value is, of course, an index of the labour cost involved in getting it. The gold-mining industry is admittedly the least remunerative of all industries—one knows the popular tag that more gold is put into the mines than ever comes out of them. There is in addition the considerable cost of its transport and insurance. So the Western world gradually reverted to what

is practically the notched-stick system, except that the actual instrument employed was made much more difficult of imitation. At first the gold was weakly diluted with a small note issue. Then the banking credits operating by the medium of cheques stepped in and gradually filled the channel of circulation, until the proportions were strikingly reversed. In the end, the currency consisted of paper credit instruments slightly sprinkled with a few gold pieces; and since the war gold has practically gone entirely out of internal circulation in this country. Whatever the effect on prices and foreign exchanges—we shall deal with that later—the fact remains that the paper currency is functioning without hitch or breakdown.

CHAPTER II

CHAPTER II

I.—FACTORS OF ECONOMIC PROGRESS

At this stage of our inquiry, before we examine more precisely the services which the institution of money renders to industry and production, we must make a general, though much condensed, survey of the factors which operate in the evolution and progress of economic welfare. Certain factors leap to the mind at once. Thus, it is evident that economic progress will depend (1) upon the development of the habit of steady industry; (2) on the skill acquired by experience; (3) on the handing down of the knowledge gained by practice and experience from one generation to another; (4) on the division and sub-division of tasks, whereby skill is more highly developed and effort is much economised; (5) on the locating of various industries to areas where nature offers the better facilities for their

execution; (6) on developing means of transport and communication; (7) on a close study of the capacities of various soils, and the best methods of cultivation and extraction; (8) on a study of nature generally and how to harness her immense forces to the service of man; (9) on the invention of labour-saving appliances, and finally machinery—all depending on systematic and prolonged education; (10) and generally on a widely developed co-operation between the many sections of producers—the more world-wide the better. By 'co-operation' I here mean the unconscious dovetailing of parts consequent on the division of tasks, not the conscious co-operation of a corporate body. The latter is only at its beginning. I do not suggest that I have exhausted even the obvious factors.

2.—WHAT IS 'CAPITAL'?

But the factor which concerns us primarily in our study of money and credit is the factor of Capital. We have seen that the term 'surplus' is used in two different

senses; and we are now to find that the term 'capital' is used in at least three different senses. Unfortunately, the student of Economics finds this sort of confusion meeting him at almost every point. You see, unlike practically every other science, which started, as it were, from zero—that is, before any one knew, or thought he knew, anything about it—and thus had to invent its own technical terminology, the science of Economics came very late into the field, ages and ages after man had been manipulating the processes which the science sets out to analyse, to classify, and to discover the causes and tendencies which make for human welfare or the contrary. The result has been that those engaged in the manipulation had come to believe, and do obstinately believe now, that they knew about it all there is to be known; and there gradually accumulated an exhaustive terminology of the market, much of which has been adopted as the terminology of the Science. It is in the nature of such a terminology to be chokeful of indefiniteness and ambiguity—nay, of terms being

frequently used in diametrically opposed senses, as we shall see before we have done —and the consequence frequently is confusion worse confounded.

To many people, the term 'capital' stands for one's total possessions, synonymous with what one understands by 'assets.' Thus by a Capital Levy is understood a tax based on the value of a person's total assets. Others use the term 'capital' to mean a man's money or command of money. Then comes the technical meaning which is meant to distinguish that part of a man's or a nation's wealth which is used for, and contributes to, the production of more wealth—as tools, implements, machinery, shops, factories, telegraphs, telephones, and many other things, in so far as they are used, not for direct consumption, but as the means of producing new wealth.

I am no stickler for definitions—that is to say, I do not insist that a certain term must be used in a particular sense, and in no other; or that a demonstration is any the less valid because a given thought is expressed by a term which I should have

used to express a quite different thought. By all means use a term in any sense you choose, provided that, having given it a definite meaning, *you stick to it*. I grant that a term used in a sense contrary to the commonly accepted meaning is liable to cause confusion amongst others; but as between the parties engaged in a process of reasoning, all that is wanted is that the meaning shall be made clear. What does matter is that the conclusion shall follow from the sense given.

Let me illustrate. 'Wealth' is fairly defined as consisting of all things which commonly have exchange value; but there are those who hold that skill should also be included in the meaning of wealth—a possession which I should prefer to designate by the term 'potential wealth.' Apart from any conclusion to be deduced from the postulate contained in either definition, it matters nothing which meaning you choose; except that, having chosen the wider conception, one ought to find another term for expressing the narrower conception. But now let us put it to the test of a demonstration:

Jack Jones has wealth, hence he cannot be in want. Now, this conclusion certainly follows from the narrower conception of wealth. But if Jack Jones has only his skill, it emphatically does not follow that he cannot be in want. We know that skilled workers sometimes are in want. I leave the reader who has studied logic to work out the formal syllogism.

In thus clearing the ground, I trust I have not wasted either space or my readers' time. Clear thinking is a jewel beyond price; and is, moreover, extremely rare. (I am not unconscious of the egotism implied in the last sentence.) We are now in a position to continue our subject with greater confidence; which I shall endeavour to develop in orderly sequence.

3.—FOOD IS THE PRIMARY NEED

The primary need of man is food. It is only when man has learned to produce a surplus of food beyond his own needs that other occupations can possibly come into existence. Given such a surplus, what

occupations will next come into being will depend upon what is demanded by the food producers in exchange for their surpluses. With continued increase in food producing capacity, more new trades will spring into being, all of them competing primarily for the possession of food. When those engaged in the new occupations can also produce surpluses beyond that which they need to exchange for food, they will exchange the sundry surpluses among themselves, thus adding to the conveniences and comforts of life. Of course, they will call it buying and selling; but in reality it is only a method of exchanging in a roundabout way.

4.—CAPITAL IS A RESULT OF SAVING

Let us now suppose two farmers possessing farms of equal extent and fertility of soil, who are of equal ability and industry. One of them exchanges the surplus of food-stuffs which he has produced for many other things which he needs or desires, and consumes the full equivalent of what he has produced. But the other is of more

frugal disposition, and therefore has some of his surplus product left on hand. He may elect to store up some grain as a standby for a 'rainy day'; and this would be added to from year to year, until some of it goes mouldy and perishes. But experience has taught him that some of his produce is occasionally, or frequently, spoiled by the weather, for lack of a place where it could be stored under cover. So he bethinks him of asking a certain hut-builder to build him a barn wherein to store his farm produce, in exchange for the surplus foodstuffs which he finds left on hand. (We are supposing a state of barter, to simplify the conception.)

By the act of abstaining from consuming as much as he could have done, he provides himself with a barn. His 'saving' has resulted in the creation of 'real' capital, whereby the future productivity of his farm is increased. Encouraged by the result, and finding that next season he has a still larger surplus on hand, he uses that for creating more capital. He employs others to fence in his fields more securely, to protect his crops from animal depredations; perhaps

he has the marshy portion of his farm drained, by digging trenches to carry off the water. Men of brains and ingenuity are induced to invent more efficient farming tools, to offer in exchange for the surplus food which they need. Saving, in short, creates capital —I mean 'real' capital—and capital is a factor of economic progress.

5.—SOME COMMONPLACE TRUTHS

From this simple example there emerge several 'commonplace truths' which the reader should carefully register and firmly fix in his mind, lest the consequences which follow from them should be disregarded when later he becomes involved in 'money terms,' which present a distorted image of the economic reality. The most commonplace of these truths is the fact that the surplus, or saving, does not, of itself, get converted into a barn. Some one must work to make the barn; but in order to work he must eat. The surplus created by the farmer provides the necessary sustenance for the worker, and thus becomes

the means of creating capital, whereby future productions will be increased.

When in course of economic evolution man barters in a roundabout way, by the intermediation of money, with periods of varying lengths intervening between the giving up and the receiving of an equivalent in return, the farmer, instead of having a surplus of farm produce left on hand, will send the whole of his produce to market, and be left with a surplus of money. When he decides to expend that money in building a barn, we think of it as the money having provided the barn. Well, it has been the means of doing so in a more roundabout way than before; but the essential facts remain exactly the same. You do not place the money on the ground and find it converted into a barn. Men must build the barn, and they must have sustenance. The surplus money which the farmer hands to them constitutes a claim on the food which he has placed in the market, or its equivalent.

Well, you will say, but that food may already have been consumed by others.

So it may. But those who handed in claims on that food obtained those claims by placing some other goods in the market —let us say boots. Another farmer presently wants boots, and he will obtain the claims on the boots by placing a fresh lot of food in the market; and it is this food which the barn-builders will get. But man does not live on bread alone. The claims which the builders get from the various people who engage their services must be sufficient to include other necessaries; and the money handed to them by the particular farmer under consideration may be exchanged for boots, clothing, and many other things which may have been placed in the market by those who demanded the food put there by the farmer.

Finally, the farmer, in common with all who are engaged in producing on an appreciable scale, ceases to receive money in return for placing his goods in the market for others to consume. Instead, he receives a claim, commonly known as a 'credit,' registered on a paper document, entitling him, in effect, to demand from the market

the equivalent in value of what he has given up. (I am using the term ' market,' not in the concrete sense of some particular market place, but in the abstract sense of things intended for sale.) These 'credits' are practically invariably deposited with bankers; and when the farmer wants the barn, he transfers some of his surplus credits to the builders. The essential facts still remain the same—*i.e.*, that the builders draw upon the food in the market for which those credits stand, or upon what has been put there by others in exchange for that food. Neither money nor credit can materialise into a barn. Men must labour to produce it; the producers must have necessaries for subsistence; hence the credit must stand for things actually available for their consumption. We shall see presently how the consequences which follow from this commonplace truth are most absurdly lost sight of and distorted.

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6.—SUMMARY

Let us now take stock and see where we stand. Man begins as a self-contained economic unit, eking out a scanty subsistence with his own hands; but presently learns to barter. With the institution of barter, occupations begin to be specialised; and when later money in some form steps in as a medium whereby barter is effected in a roundabout way—we now call it 'exchange'—specialisation is developed much further, and man becomes progressively more dependent upon the co-operation of his fellows for the provision of the many things which he needs or desires. Each worker is then producing much more of some given commodity than he needs or intends to consume, the surplus product to be exchanged with others, generally by means of regular markets, but also by the intermediation of dealers or middlemen. As a result, production is immensely increased (1) by the acquirement of skill consequent on continuous practice, and (2) by the economy of

effort wasted in shifting from one occupation to another.

Food production is of necessity the primary occupation; and other occupations can only rise into being just in proportion as the food producers can create a surplus of food beyond their own needs. Given perfect freedom of access to natural resources and to the necessary tools of production, the clear tendency is for other occupations to come into being in a progressive order of their capacity to satisfy needs; for the reason that the food producers, for whose products all others are primarily competing, would, as a general rule, demand necessaries before they demanded things of superfluity and luxury. But with the appropriation of land into private ownership and the accumulation of the implements of industry in a few hands, this tendency is considerably abrogated. This, however, is a matter outside the scope of the subject we have in hand, and which would occupy far more space than we could possibly give it.

7.—CAPITAL AS A FACTOR OF ECONOMIC PROGRESS

We can now picture a state of economic evolution when the various industries which came into being had become equated to needs, and every one consumed the full equivalent of what he has produced. There would still be room for increased production, as a result of acquired skill, or by working harder, or longer hours; but if that only served to a proportionate increase of consumption, society would practically remain in a stationary condition of economic development. We see that condition amongst what we call ' backward ' tribes or nations. The principal factor to increasing production would be lacking. Man is a tool-using animal; and the greater the efficiency of the tools he is using the greater becomes his producing capacity. The term ' tools ' must be understood in the widest possible sense. He wants not only improved manual tools, but good roads, good bridges, efficient transport and communication, buildings for

working and for storage, good harbours, and an endless number of other aids to production; to say nothing of modern machinery. Fertile inventive brains there may be in plenty; but so long as there is no surplus of necessaries available for the maintenance of workers who could be withdrawn from other occupations and set to producing capital, the fertile brains can do but very little.

Saving, then, is the very soul of economic progress; but there is an all-important condition attaching to that, which we shall see in a moment. I just want to say a word first as to the institution of money being a powerful promoter of saving. Without money, saving would mean the storing up of goods of all kinds; and these goods could, of course, be used in 'payment' to others who would produce capital in return. But unless the surplus wealth is so employed as it accrues, the inducement to store up goods for future use is nothing near so powerful as the inducement to save general purchasing power, to be expended when and how one desires to do, and which can

be kept for any length of time without deterioration. In primitive societies, for example, surplus wealth is stored in increased herds of cattle. But money is a form of saving which strongly appeals to most people.

8.—SAVING : AN ECONOMIC PARADOX

But there is a condition to the beneficence of saving, which Adam Smith, the father of Economic Science, has immortalised for all time in the form of a striking paradox. If saving is to promote economic progress, 'What is saved must be consumed.' Savings may be hoarded; but hoarding is the deadly enemy of economic progress. We have seen that new industries spring into being as a result of the existence of surplus *products*; that capital can only materialise as a result of employing surplus *wealth* for the maintenance of those set to producing capital wealth. But here is a producer, *e.g.*, a farmer, who sells the whole of his surplus product; and that portion of the money which constitutes his surplus wealth he buries under the hearthstone or locks up in a

safe, and keeps it hoarded. The result is that the demand for those products is less by the amount of claims on them—what we call purchasing power—which is hoarded up. That does not necessarily mean that the products will remain in the dealers' hands unconsumed; but it does mean that they will have to be disposed of at less than current prices, probably at a loss, since the effective demand at current prices is so much less than the supply. This aspect of the matter we shall discuss at a later stage.

But another farmer puts his money or credits into a bank. The banker issues loans against the credits deposited with him—in effect, he transfers the credits owned by one person on to another person. It is true that he does not actually write-off the credits of his customers by the amount of the loans he granted; but that is only a question of form rather than of substance. Experience has taught him what proportion of the deposits are habitually called for by his customers; and, except only during such abnormal times as the nation being at

war and then only with Government guarantees and protection, he takes good care that the amount of his loans shall not trench upon the amount likely to be called for by his depositors. As soon as he finds that the demands of his depositors pass the customary limit, he calls in his loans, most of which are at short notice or at call.

What follows is obvious. The surplus wealth—the savings—instead of being hoarded, are now being consumed. The surplus wealth created by some are put at the disposal of others, and are consumed by workers who are employed (1) either in extending established industries, or (2) in starting new industries, or (3) in producing new capital, or (4) in renewing old capital as it gets worn out. In the first two the loans are repaid out of the surplus wealth of consumable goods produced, and in the last two they are repaid in the long run out of the increase in production occasioned by the use of the created capital. If all money and credits were deposited at banks, and bankers could lend out the whole of the

deposits held by them (less till money) economic progress would be accelerated.

9.—WHAT IS THE PROCESS OF FINANCING?

I have now arrived at the point towards which I have been steering my course all through this chapter, after which we shall resume our main subject. What exactly is the process known as Financing? In one sense, financing is merely the art of balancing accounts, debits against credits, expenses against income. But this is not the sense in which it is commonly understood. Generally it is held to mean the provision of a supply of money for carrying on industries, for curing famine, for doing all sorts of desirable things. Money is the Aladdin's Lamp which creates all things at will. There are any number of cranks in the world who believe that all economic ills are curable by the manufacture of a plentiful supply of legal-tender money; and their published views apparently meet with some degree of acceptance.

The reader who has followed me so far

has, I trust, fully grasped the position, and will need little more than a phrase, or formula, by which it may be expressed concisely. Financing has to do with the management and administration of surplus wealth created by producers, the administrative machinery being the credits constituting valid claims on that surplus. It is because the whole world is now practically one economic unit; because credits are largely international; and because the bulk of credits are collected in central pools, and are managed by people we call bankers: that the mechanism of finance is of so complex and delicate a character, which may be made to confer immense benefit to industry and commerce, or may easily go wrong and cause much injury if it is managed inefficiently, dishonestly, or on wrong principles. This subject will be developed further at a later stage of our investigation.

Just a few further words on the term 'capital.' Money and credits are also called 'capital,' in common with actual implements of production. It is a pity that different names should not have been found for

things so distinctive in character. The difficulty is met by tacking on qualifying descriptions to the term capital. Thus, the implements of production are described as 'real,' 'fixed,' or 'true' capital; while money and credits are defined as 'liquid' or 'fluid' capital. Since I am not competent to invent a new generic name for money and credits that is likely to be generally accepted, I must follow the accepted terminology. Of course, the surplus on which money and credit constitute claims may be used for producing capital; but equally it may be used for producing consumable goods, or may be consumed unproductively. We have here one more example of the ambiguities inherited from the terminology of the market.

CHAPTER III

CHAPTER III

I.—A 'PAWN-SHOP' SYSTEM

We have arrived at the stage when the great bulk of international exchanges of goods and services are carried out by the medium of credit instruments of no commodity value; and when the internal exchanges of many countries are accomplished wholly by such instruments, less an insignificant quantity of metallic small change which do not represent the commodity value for which they stand, and are, therefore, called token money. What is not realised is, that even when an exchange is effected by means of a commodity medium—*e.g.*, gold—it is still in essence a credit transaction. The difference is that, where a commodity medium is employed, the return of the expected equivalent is assumed—I use the word 'assumed' advisedly—is, I say, assumed to be fully guaranteed and made sure of by the fact

that the medium itself has the commodity value of what the seller had given up, even if it were demonetised. It may, therefore, be called a ' pawn-shop ' system, where the seller receives a ' pledge ' which must always fetch as much as has been advanced. But even so, the actual equivalent—the ultimate barter—is not realised until the original seller had exchanged the medium for what he wants for his actual use. In a word, then, whatever the credit instrument, its essential nature is a claim to the return of an equivalent; and the point at issue—the only point—is what medium will best ensure the honouring of the claim.

2.—THE ' FREE-MONEY SCHOOL '

Here we come to a parting of many ways, most of which end in a complete cul-de-sac. Whatever the nature of the schemes they advocate, all of them seem to have forgotten, or to have never realised, the essential nature of money—a claim to the return of an equivalent. Legions of visionaries have evolved wonderful schemes for regenerating

the world by means of a plentiful supply of legal-tender paper money. They differ much in detail, but one root fallacy runs throughout all of the schemes. These had better be cleared out of the way before we enter upon the more serious and practical side of the issue involved. These advocates of a plentiful supply of paper money have for long been known generically as 'The Free-Money School.' Mr Arthur Kitson and Major C. H. Douglas are, I believe, the modern High Priests of this school. At one time they had an 'understudy' in Sir Oswald Stoll; but he, I fancy, has turned in his tracks.

The argument runs somewhat as follows: Since credits function as money in actual fact, the quantity of money issued need only be limited by the amount of securities of all kinds on offer, less some reasonable margin of safety. Nay, in the case of Governments issuing the money, it need not be limited by the actual tangible assets of the country, since a Government is in a position to pledge the future producing capacity of the nation. If, then, in addition

to issuing the money, the Government owned the business of banking, the interest charged for loans need be no more than nominal, just sufficient to pay the costs of administration. Thus, instead of production and commerce languishing for want of capital, there would always be capital for those who can offer tangible security—as land, houses, factories, machinery, stocks and shares, and all sorts of saleable assets. There would then be employment for all, and the nation would flourish and grow rich. Such is the entrancing picture.

3.—'CREDIT' AND 'CREDIBILITY'

Perhaps the reader has by now already surmised why I have ventured to remind him of the obvious truism that, when the hunter gives up a skin to the farmer, who promises to return later an equivalent in farm produce, the hunter has a 'credit,' while the farmer has a 'debit.' Of all the ambiguities and misconceptions which are our legacy from 'the terminology of the market place,' the misuse of the term

'credit' is the most preposterous and ludicrous. The lender has a credit; but the borrower is also said to have got credit. But they cannot both have got credit, since they are the antithesis of each other. We say of a tradesman who has money owing to him by customers of position and repute that he holds good credits; and we also say of one who is in a position to borrow that his credit is good—meaning thereby that his 'credibility,' or trustworthiness, is of a character which enables him to borrow, and thus incur a debt. 'Credit' and 'credibility' have got inextricably mixed up, to the utter confusion of clear thinking.

Pray do not run away with the notion that it is only a question of terms. It is just one of those 'commonplace truths' which, being overlooked, an utterly topsy-turvy conclusion is reached. You say that credit is money. I agree completely—I more than agree—I insist emphatically that money is a credit even when it consists of a piece of gold. One does not need money to buy of oneself what one has produced

himself. Money comes in when men exchange things one with the other. To do this, there are, as I have said, only two possible alternatives. It is either, 'I give you this and take that'; or it is, 'I give you this to-day and will demand the return of an equivalent some other day.' The one who has given up something for another to consume holds a credit, recorded on some instrument—no matter what—which becomes his money—in other words, his visible claim to the return of an equivalent. Of course, the credit can be transferred from A to B and still be a true credit. But see what this absurd misuse of the term 'credit' leads you to. A gets a credit created for him, when he has given up nothing for any one else to consume, nor has any one done it on his behalf. He borrows on the strength of security which remains in his possession. It is not a 'credit,' then, that becomes money, but a 'debit.' In other words, unless a true credit has been transferred, a spurious claim is created, very little distinguishable from a pure forgery.

4.—THE BUSINESS OF BANKERS IS TO 'TRANSFER' CREDITS

Major Douglas contends that bankers do actually 'create' credits, because when they issue loans or allow overdrafts they do not write off a corresponding amount from the credits standing to the names of their customers, which are, of course, liable to be demanded. With this point I have already dealt in anticipation. Let me give an illustration. Of those booking seats at theatres a certain number are invariably unable to turn up. Let us say that experience has proved that this number is never less than five per cent. The management can then sell an extra five per cent. of seats, the excess being sold conditionally that the holders must take what seats there happen to be vacant. Could it be said that they are 'creating' seating accommodation which has no existence in fact? The argument is that it is the business of bankers to 'create' credits, and that being so, they should create sufficient for all industrial and commercial

needs. As far as I can follow Major Douglas—for he writes in a manner which is by no means easy to follow—they refuse to create the necessary credit because of, what he calls, 'the will-to-power': the determination to keep full control of the financial machinery of the world. And this motive is apparently strong enough to overcome their distinct self-interest, since the more credits they advance the greater their income. But it is the business of bankers to 'transfer' credits, not to 'create' them! Let me enforce the point by another illustration.

At a children's school treat, one of the items consisted of a distribution of tickets for prizes to be drawn out of a bran tub. A larger attendance having turned up than was anticipated, the prize tickets did not quite go round. One of the ticketless youngsters started blubbering. 'I am awfully sorry, sonny,' pleaded the teacher, 'but I really cannot help it—there are not any more tickets left.' 'Write out some more,' tearfully responded the aggrieved youngster. A great number of grown-ups

are like that boy. They do not appear to realise that before prizes can be drawn out of a bran tub some one must first put them there. They propose to manufacture claims on things in the market which are not there to be claimed. The result will be, of course, an inflation of money in relation to things; and the consequence a gradual rise in prices until a new equilibrium is established. The tendency to an equilibrium is nature's universal law. This aspect of the matter we shall have to elaborate further presently.

5.—MONEY IS A 'CERTIFICATE OF DELIVERY'

The reader will be much assisted to a realisation of the position by conceiving money in any form as being a CERTIFICATE OF DELIVERY, or a Bill of Lading. The latter is a valid demand on the cargo in the ship. It is manifestly useless to create a Bill of Lading if no cargo has been put in the ship. There is only this difference between a Bill of Lading and our 'Certificate of Delivery': that whereas the former is a

demand on a specified cargo, the latter is a demand on any goods offered for sale to a named value. But just as the cargo must be in the ship if the Bill of Lading is to serve any purpose, so the goods must be in the market if the 'Certificate' is to serve any purpose. The question of security is utterly beside the point, since the values named as security are not in the market to be claimed. There is no longer an equilibrium between supply and demand at *current prices*. In a word, money is a credit; and, conversely, credit is money when it is a 'true' credit, not a spurious claim standing for nothing that has been given up. Of course, the credit of one can be transferred to another, when it is still a claim to the return of an equivalent.

I have heard it contended that a credit, when it is not a claim on what has been contributed in the past, can still be a claim on future production; and as such may help to set industry going. Oh, yes; a credit generally is a claim on future production. Just think it out. A has contributed something, and holds a claim to the

return of an equivalent. B demands what has been contributed by A, consumes it, and it is, perhaps, no longer in existence. But how does B get the demand which gave him the right to consume what has been produced by A? Why, by creating something else which he places in the market for others to consume. In the course of roundabout exchanges, what has been contributed by B may be consumed by C, and so on down to Z: and all these various products except that created by Z may no longer be in existence. But in the end A gets his return by demanding what has been produced by Z. It does not require much imagination to visualise the economic process as being both prospective and retrospective. We are consuming what has been produced in the past, and are producing what will be consumed in the future. But there must be equivalence if the mechanism is not to break down.

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6.—THE 'QUALITY' AND 'QUANTITY' THEORIES

So much for the muddle-headed confusion of thought between credit and credibility, or trustworthiness. Dismissing that from our minds, we find that the two main streams of controversy have their source in what is called the 'quality' school of money, represented mainly by the older economists, on the one hand, and that of the purely 'quantity' school, of the modern type of economist, on the other hand. There is, I think, no serious difference of view on the 'first principle' of currency. Whatever the 'medium,' it must stand ultimately for an exchange of things or services; if it is not that, then one of the parties must have obtained something by chicanery or fraud. (When currency is manufactured by a Government, it is, of course, purely a tax; but that is supposed to give the nation value in return.) Whatever substance money consists of, it must be a record of something given up, entitling the holder to demand

an equivalent in return. The controversy and obscurity arise from the question : What kind of instrument is likely to function without hitch or breakdown, since a breakdown in a currency system, particularly under modern conditions of world-finance, is a proved cause of disastrous consequences to trade and production.

The ' quality ' school maintains that, if the instrument is to be relied upon to function without breakdown, it must consist of some marketable commodity, equal in value to that which has been given up. True, its essential nature is a claim on some other thing; but the point is to make quite sure that the claim will be honoured. On the face of it, a commodity such as gold, so much in demand all over the world, cannot fail to be accepted; to say nothing of its other qualities which make it so suitable for employment as currency. But a mere promise recorded on a substance of no commodity value may go wrong; it has, in fact, done so on many occasions. Hence they pin their faith to what I have called the ' pawn-shop ' system.

7.—CONVERTIBILITY

When it is pointed out to them that, though metallic money was at one time the only medium, man had to go back to token money; and that since the cheque system had become established the proportion of metallic money to paper credits had become an insignificant fraction: they reply that, even so, the maintenance of gold as the standard, and the right of convertibility on demand, operates as a steadying element, maintaining the functioning capacity of the paper credits. They admit that the right of convertibility is largely a pretence; that the fiction is kept up in reliance on the knowledge gained by experience that no more than a small proportion of gold is ever demanded except under panic; that there is never sufficient gold to meet anywhere near the possible demand; that British law actually provides for abrogating that right by proclamation; and that this abrogation had to be put into force on several occasions. Nevertheless, they argue, these

are only the exceptions that prove the rule. When it is pointed out that for a number of years, gold had practically gone entirely out of circulation in this country, and that our 'Bradbury' functions without breakdown, they reply: Yes, but with what result? The 'Bradbury' will only buy 14*s.* worth of goods in the United States. Effective convertibility would have kept exchanges at par, fluctuating only within the 'gold points.'

8.—MONEY INTRODUCES AN ELEMENT OF GAMBLING

What, then, is the position of the modern, or 'quantity' school? To follow the argument clearly, we shall have to elucidate certain other points in orderly sequence. The first thing to realise is that money, which enables roundabout barter to take the place of, what I have called, the natural method of exchanging, can never be a replica of direct barter; and in that sense it can never function quite efficiently. The farmer who barters his produce for some

other commodity cannot, of course, rely upon getting as much of that commodity in exchange for his produce on every occasion; it will depend upon the relative abundance or scarcity of the respective products at the time the barter takes place. But, at any rate, he strikes the bargain with his eyes open, knowing exactly what he is getting. But when money intervenes, and some appreciable period is allowed to elapse between the giving up and the getting of something else in return, the seller enters upon a gamble, whether he is conscious of it or not. By the time he decides to spend the money, the thing which he wants may have become scarce, so that he will get less of it than he could have got at the time he gave up his product; or it may have become more abundant, so that he will get more. In short, the lapse of time introduces an element of uncertainty and variation.

9.—COMMODITY MONEY IS A 'DOUBLE GAMBLE'

But so long as the money is a non-commodity token—a mere 'Certificate of Delivery'—the seller is only faced with one element of uncertainty: that is, the scarcity or abundance of what he finally decides to buy with his money. But when a commodity becomes money, chosen to serve that purpose for the very reason that it is much in demand for other purposes than money, the seller has to face a double gamble. Either the particular goods which he buys with his money may have become scarce; or the particular commodity which functions as money may have become more abundant. In either of these cases, the money will buy less of the thing he wants than it would have done at the time of his sale. Or the two causes may operate simultaneously—that is to say, the thing which he buys had become scarce and the money with which he buys it had become abundant. When cowrie shells function as money,

some enterprising tribesmen may have brought in a few extra sacks of them from some far-off coast; and when gold functions as money, a new gold-mine may have been discovered.

10.—GOLD AS A 'MEASURE' OF VALUE

Of the many frauds perpetrated in the name of science, the orthodox doctrine that gold is the 'measure' of value will rank as not the least pernicious, for the reason that it mostly victimises the poor and needy; and that its evil effects on commerce and production are subtle and not easy to rectify. When we say of a certain metal rod kept in the Tower of London that it is our standard measure of length, we know that, by means of that measure, when we pay for a yard of stuff we can be sure that we are always getting the same specified length. But the gold disc which we employ as the, so-called, 'standard' of value will purchase varying lengths or quantities at different periods, just because there is a variation in the quantity of the metal, not

necessarily in circulation as money, but even when it is only in gold bars. This fact is now quite undisputed. We have it on the authority of Professor Stanley Jevons, who investigated on behalf of the Government, that in the twenty years between 1789 and 1809, gold fell by 46 per cent.; then in the subsequent forty years the value rose by no less than 145 per cent.; then it fell back between 1849 and 1874 by at least 20 per cent.

II.—A QUESTION OF 'QUANTITY'

The problem is wholly a question of quantity. If, say, for every thousand units of money going to market to buy goods there are a thousand units of goods seeking buyers, they will exchange unit for unit. If the units of money are doubled while the units of goods remain constant, then, after some short period of oscillation—Professor Irving Fisher estimates that at six weeks—during which buyers and sellers are, as it were, feeling their way, a new equilibrium will be established, when two units of money

will be given for one of goods—prices will have doubled. During, and for some time after, the period of transition, wage and salary earners will be victimised, creditors will lose and debtors will gain; and there will be a general disturbing effect on production. After much bickering between capital and labour, and probably strikes spreading havoc all round, wages may rise to meet the new level of prices; the professional classes will not fare so well; and those living on fixed money incomes will suffer most and longest.

In the very nature of the case, fluctuations cannot be escaped where money consists of a commodity, of which nature alone controls the supply. But where the money instrument is simply a 'Certificate of Delivery,' though it is manifestly open to enormous abuse by spurious issue, while commodity money is at any rate limited by nature somewhere, the 'Certificate' money is wholly within human control, and only requires strict honesty, and the aid of art and reasonable precautions, to eliminate fluctuations entirely. If every money unit stands for a

unit of goods delivered into the market, then the more there is produced the more 'Certificates' will be issued, and when less is being produced, the Certificates that come in for purchases will not be re-issued. There will be no general rise in prices, because an equilibrium will always be maintained between the units of money and the units of goods. Of course, there must always be fluctuations in values as between one commodity and another, since nature varies her moods, and man has no sound basis of calculation which may enable him to co-ordinate supply to needs amongst the many commodities which he is producing; but that is quite a different matter from a *general* rise or fall in prices.

12.—INFLATION OF PAPER MONEY

You say 'it only requires strict honesty,' the upholders of the 'quality' theory will reply; but that is just where the rub comes in. Where is this strict honesty to be found? Look at the world's experience in this matter. The adherents of the 'Free Money

School' have had their day: John Law, the French Assignats and the 'Yellowbacks' have caused no end of misery and ruin. In times of stress, all States fly to printing legal-tender money in huge quantities—what you would call 'Spurious Certificates.' Beginning with Russia, and descending the scale through Poland, Austria, Germany, England, and the United States—to say nothing of the small new-born nations—myriads of notes have been issued, until, as in Russia, a mountain of roubles has to be given for a piece of bread which formerly cost one kopeck. Is this the kind of experience to encourage the world to adopt a wholly paper currency? We admit that metallic money must fluctuate in purchasing capacity; and will grant that the statement that gold is a 'measure' of value is largely misleading. But this is a mere bagatelle in comparison with the possible inflation of paper money. The fluctuations in the value of gold are, at any rate, gradual, and limited *somewhere* by nature; whereas the reckless outpourings of a printing press are limitless.

To which the upholders of the 'quantity'

theory have an obvious and complete reply. They point out that the evil of paper inflation is not escaped in the least under the system of a mixed currency—that it has just taken place under our very noses, though the 'gold standard' nominally holds the field. If the proposal were to entirely discard paper credit currency; that all sales and purchases should actually be for gold (less, perhaps, the minimum of small change); then the argument would be valid as far as it goes. But no such proposal is made, or is even conceivable. But short of this, the argument has no bottom to it. The bigger part of the inflation in this country consisted of banking credits, which rose from 1070 millions to 2300 millions! Is it proposed to abolish banking credits?

Man has never the choice of the wholly good from the wholly evil; it is always a choice of the lesser of two or more evils. If the contention is that no State can under any circumstances be brought to administer a currency honestly; that no matter what the system adopted and precautions taken, officialdom will always find the means of

circumventing the intention and of playing havoc with the currency: then a reversion to gold money *solely* is the only remedy. But such a proposition is simply unthinkable at the present day—all the gold in the world could scarcely provide a decimal fraction of the amount that would be required. When the Bank Act of 1844 was passed, it was held that 'convertibility' would prevent inflation; but we have seen that it has not done so. You may say that this took place just because the principle of 'convertibility' was subverted; but since your argument is that a State cannot be trusted to stick to a principle when it suits the governing power of the day to break it, then this contention goes by the board.

But if, on the contrary, Governments can be made to stick to principles, when they are well defined and generally understood and approved, then it is unpardonable folly to waste an enormous quantity of human labour in procuring gold for use as currency, when a medium which can be produced with infinitely less labour will answer the purpose as well or better. In a time of

acute national stress like the one we have recently passed through, probably nothing will stop a Government from raising the means for carrying on by all the three methods open to it—that is, by taxing, borrowing, and inflating the currency. To be quite just, it must be admitted that the creating of legal-tender paper money, apart from being a method of taxation—a very inefficient and wasteful method—was also an unavoidable necessity at the moment, in view of the fact that the credit system was on the point of suddenly collapsing, as was quite manifest, which would have caused irretrievable ruin. But this does not help the 'quality' theorist, since it was the run on gold—a 'run' which could by no conceivable means ever be met—which threatened the collapse.

Provided each currency unit stands for a true credit—a 'Certificate of Delivery'—it cannot go wrong. The maintenance of an equilibrium is the sole key to the problem. Civilised man is so abjectly dependent on the possession of a currency that the question whether the intermediary is a 'pawn-shop

pledge' will not affect him in the least. We see that it does not do so now, though gold has ceased to circulate. He wants a valid claim; and that will remain valid so long as the equivalence between currency and goods and services on offer for it is not violently upset. The problem, therefore, is to see to it that every currency unit shall be a true credit, and that no spurious claims are created. The primary means for bringing about that result is to make this very simple principle thoroughly and popularly understood. There will then be no difficulty in devising a system that will carry this principle into practice. This we shall develop further before we conclude.

CHAPTER IV

CHAPTER IV

I.—RICARDO'S LAW OF THE DISTRIBUTION OF THE PRECIOUS METALS

BUT the indictment of the 'gold standard' is not yet complete. The lack of stability in the purchasing capacity of gold is not alone due to nature's variation in the supply of the metal—or, rather, to man's capacity for discovering and availing himself of nature's resources—but is also, and largely, due to the variations in the distribution of what gold there is amongst the various countries. We must begin by explaining the well-known Ricardian Law of the Distribution of the Precious Metals.

In gold standard countries, *e.g.*, the quantity of gold that will be required for use as money will obviously depend upon the extent of the country's trading—in other words, the total volume of exchanges. That, as we know, does not mean that the gold

will equal the volume of exchanges—which is not possible—but that it must be some definite proportion of the total; and the proportion will depend upon the extent to which the currency consists in part of credit documents. Thus, a country like England, doing a large trade, will require a smaller proportion of gold to the total of trading than do other countries, because its system of bank cheques and other credit documents has been so highly developed. But whatever the proportion, it must bear some definite relation to the total.

Now, the Ricardian Law postulates that whatever gold there is available in the civilised world for purposes of money will have the tendency to distribute itself amongst the various countries in proportion to their needs for it. The way this tendency works out is already familiar to us in substance. When, through an excess of imports over exports, or some other accidental conditions, a given country, call it A, has to part with some of its needed gold to discharge its balance of debt to country B, the result is a deficiency of gold in A, and an excess of

it in B. The consequence is that in country A prices fall—since the scarcity of gold in relation to goods raises its purchasing capacity—while in country B prices rise. What then happens is that merchants in country B make a rush to buy goods in country A where prices are lower, to sell in their own country where prices are higher. The result is that the balance of indebtedness gradually turns the other way about, and gold has to flow back to country A, until the balance of gold to needs is restored, and prices find their level.

It will scarcely be necessary to impress upon the reader that a tendency to an equilibrium is not the same thing as a permanent equilibrium—that it is just a movement towards a given point, oscillating this way and that, by the constant clash and interaction of many forces. It is so throughout nature. Hence the fluctuations in prices due to changes in the distribution of gold (apart from changes in nature's supply of it) are rarely absent in some degree, and occasionally become very marked.

Now, whenever there had been an appreciable drain on gold from this country, it was the custom of the Bank of England not to leave it to be rectified gradually by the normal process above explained, but to hasten it on by raising the rate of interest on loans, and the payment of a proportionately higher interest on deposits. This formed an inducement to foreigners to make deposits at British banks, and to lend to merchants here at a higher interest than they could obtain in their own countries; with the result that gold flowed back more rapidly into this country, until the balance was restored. It need scarcely be pointed out that this want of stability in the rate of interest operates badly against merchants and traders, involving many in serious losses.

2.—THE 'GOLD BASIS' RESTRICTS CREDIT

But the restriction of credits by the banks, and the consequent injury to industry and commerce, was not directly proportionate to the actual change in the distribution of gold, but was much larger than the gold

deficiency, as a result of the prevailing theory of money in this country. That theory held that gold is the only real money (with some grudging concession to a silver standard); that while we could not possibly escape using credit documents as substitutes, these will only function efficiently if the holders of them were fully satisfied that they could be converted into gold on demand. But there would clearly be no point in keeping a reserve of gold equal to the amount of credits in circulation, even if that were possible. So the compromise was arrived at that a reserve of gold was to be kept equal to what experience has proved to be the probable percentage of demand for gold, with some margin over, if possible. This is what is meant by the 'gold basis' of currency.

3.—THE BANK ACT OF 1844

By the Bank Act of 1844, the Bank of England was given the power of issuing 40 per cent. of notes against their holdings of Government securities, and 60 per cent.

against an actual gold reserve. Such provincial banks as were already issuing notes were allowed to continue the issue to the amounts that were in circulation at the time of the passing of the Act; but London bankers were forbidden to issue notes; and country bankers could not restart an issue when once the old issue had been allowed to lapse. But the Bank of England was allowed to increase its issue of notes against securities beyond the 40 per cent. by the amount of the issues given up by provincial bankers. As a result of this right, by the year 1914 the issue of notes by the Bank of England was converted, roughly, into 60 per cent. against securities and 40 per cent. against a gold reserve. But the London bankers did not take the restriction placed upon them lying down. They invented the Cheque System, which rapidly grew enormously, and took much of the wind out of the Bank of England's sails. The latter made strenuous efforts to induce Parliament to squash the cheque system or to secure the exclusive right to issue cheques, but without success.

4.—THE GOLD RESERVE AND CONVERTIBILITY

At first glance, then, it would seem that the shortage of gold in the event of a panic run by all credit holders could never exceed 60 per cent.—a condition quite serious enough; but this would be quite a misconception of the true position. Up to within comparatively few years ago, the Joint Stock and private banks kept no gold reserves of their own; and even now that is the exception rather than the rule. All the other banks keep accounts at the Bank of England; and it is upon the reserve held by the Bank of England that the other banks rely in the event of an extra demand for gold. Thus, in the event of a general panic run, such as that of August, 1914, the Bank of England would not only be called upon to cash its own notes and meet its current deposits, but would have to find gold to meet the demand of depositors at all the other banks. That, as we know, amounted before the war to something over £1,000,000,000. It is true that, as against

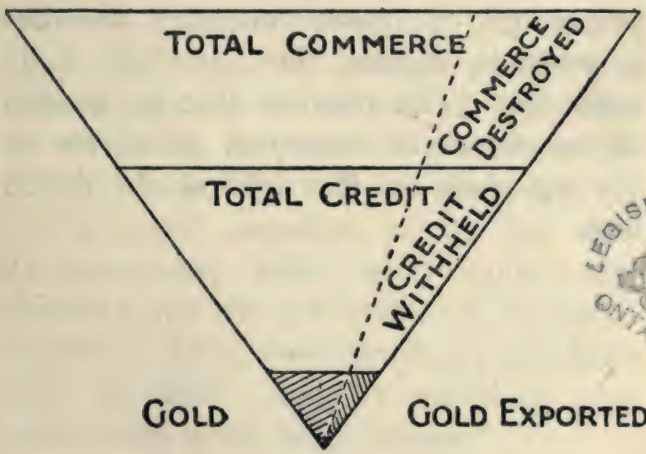
these liabilities, the banks held much credits on borrowers, a great deal of it 'at call'; but of what earthly use is it to call on people to pay gold who can only get it from the banks, upon which there is already a panic run? Securities cannot be realised, since the Stock Exchange is in the same predicament as the banks. To meet such ruinous contingencies, the Act provides that the right to demand gold can be revoked, and the banks can be forbidden to pay out gold, even if they would.

Since, then, the right of convertibility into gold depends upon the expectation that not more than a certain percentage will be demanded, bankers dare not lend out—in effect, transfer—the whole of the credits entrusted to them by their customers, irrespective of what gold there happens to be available; but must regulate their loans by the amount of gold reserve in hand, with a margin of safety. Whenever there is a special call for gold, either for home use or for export abroad, they restrict the issue of loans, and call in some of the loans that are already out. This is not, as Major

Douglas and Mr Kitson imagine, a black conspiracy against the public weal, but simply as a precautionary measure, forced upon them by the currency laws of the country and the conditions of their business. As we have seen during recent years, given the protection of the Government, they are not slow in 'creating' credits beyond the true credits at their disposal, since the earning of interest is what they are out for.

5.—THE INVERTED PYRAMID

For the following instructive diagram we are indebted to the late Sir Edward Holden:–



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The central space (ignoring the dotted line) represents the volume of credit held, on the present theory, to be dependent on the relatively insignificant gold basis; and the top space (across) stands for the volume of commerce effected by the medium of the gold and credit combined. A portion of the gold on the right of the dotted line is then exported. Because of that, bankers find themselves constrained to restrict the issue of loans, not by an amount corresponding to the gold exported, but by the much larger amount represented by the space in the centre on the right of the dotted line, for the reason that the percentage of reserve necessary to meet a probable demand for gold has been made less. The result is that an amount of commerce is destroyed, as shown in the top space on the right of the dotted line.

6.—GAMBLING WITH LOADED DICE

The *Bankers' Magazine* gave some years ago a remarkable instance of how the effect on prices caused by a transference of gold was manipulated by a group of American gambling financiers. In the course of a few weeks, this group drew from the Bank of England £11,000,000 in gold, and shipped it to New York. Confident in the knowledge that a depletion of the gold reserve has the effect of lowering prices, and that an addition to the stock of gold raises prices, they sold British securities heavily, to be delivered some time later, on the London Stock Exchange, and bought securities at current prices on the New York Exchange. In the result, the drain of gold from this country caused a fall in the prices of our principal securities of no less than £115,000,000; while there was a corresponding rise in the prices of American securities. Thus, these speculators won huge sums on both sides, by gambling with loaded dice, which could not fail.

This result could not have taken place if ideal credits alone constituted money. One can only buy by giving back an equivalent in return, so that one would balance the other, and there would be no effect on prices. It is just because the restriction of credit facilities is, under present conditions, so disproportionate to the amount of gold transferred that a gamble of the kind given is made possible. Thus, with gold as the basis of currency, we have three distinct causes of serious fluctuations in prices: (1) natural variations in supply; (2) accidental changes in its distribution amongst various countries; and (3) that the distribution lends itself to gambling manipulations. There is just as much sense in saying that gold is a standard 'measure' of value as it would be to make a standard of length consist of a piece of elastic.

I trust I have presented the arguments on both sides as fairly as I know how. Perhaps the upholders of the 'quality' theory have other arguments to advance; if so, I am not aware of them. However,

before we attempt to draw any final conclusions, we have to deal with certain other aspects of the matter, the understanding of which is essential to a clear grasp of the problem in hand.

CHAPTER V

CHAPTER V

I.—WHAT IS A UNIT OF VALUE?

WHAT do we mean exactly when we speak of 'Unit of Value'? Those who, like myself, know nothing of military organisation will frequently ask, *e.g.*, What is a platoon? and will be told by one who knows that it consists of so many individual units—I think, twenty. They will then be informed that a company consists of so many platoons; a battalion of so many companies; and a regiment of so many battalions. Each enlarged aggregate is computed from a different unit. Come to that, the human individual is an aggregate of units of cells; and the cell is an aggregate of units of atoms; and so on. Nature has, however, stamped organic life with individuality, but so much cannot be said of inorganic life; and value is certainly not a property of organic life alone.

Even where uniformity in the fixing of a unit is of the most obvious advantage, man had blundered into introducing a most bewildering heterogeneity. Thus, the unit of length varies with every nation; and so does the unit of weight; and so does the unit of money; and so does the unit of capacity. Nay, even amongst the same nation, and in expressing a relationship of the same kind—weight, for example—we find a most perplexing variety; and in this matter we seem to be the muddlers in excelsis.

Well, it is not our business here to dilate on human folly, but simply to find what is the essential point of a unit of anything. It is not necessarily something upon which nature has set the stamp of individuality or of segregation. It is just an agreed-upon starting-point of comparison or computation, fixed by mere arbitrary convention. We have fixed on a rod which we call a 'yard,' by which we compute length; and on a certain mass we call a 'pound,' by which we compute weight. It is just a question of deciding the relationship of quantities

one to the other. The mathematician starts with a mere symbol, X, which can mean anything you like, so long as it stands for the hypothetical unit from which you build up your computations. A unit of value, then, may be anything which serves as the starting point. We shall see presently, however, that a unit of value differs materially from any other kind of unit. To understand this clearly, we must first determine what is meant by the term 'value.'

2.—WHAT IS MEANT BY 'VALUE'?

The term 'value' can be used in at least three different senses. First of all, it expresses the degree of appreciation or desire. One is said to value a thing in proportion as his desire to possess it is stronger than the desire for the possession of some other thing. Now, this degree of appreciation or desire differs with individuals, and with change of conditions in the same individual. This is so perfectly patent that there is no need to illustrate it. But putting this on one side, we are faced with the insuperable

obstacle that we have no instrument by which we can measure degree of desire. Now, if a science is to have any practical application, it must have the means of quantitative analysis. Without that, we can make no valid deductions, or reach conclusions for future guidance. Value in that sense, then, is of no help whatever to the science of Economics.

In the second place, value will express an ideal degree of usefulness. Most people would probably agree, for example, that a loaf of bread is more useful than an ounce of tobacco; nevertheless, it would be a most amusing experience to get twenty people to draw up a schedule of things useful in their order of merit. At any rate, it is quite certain that exchange values, or prices, do not conform to any such list that might conceivably be drawn up. There is nothing whatever in this meaning of ' value ' that can possibly help the Economist to any reasoned deduction.

Finally, we have the meaning of ' exchange value '—that is to say, the ratio at which things exchange for each other. Thus, if

two measures of rye are given for one of wheat—or, as we should state it in terms of money, that wheat sells for just twice the price of rye—their ratio of exchange for each other is as 1 : 2. In place of attributing this fact to a cause *inherent* either in the purchaser—*i.e.*, degree of desire—or in the thing purchased—*i.e.*, degree of usefulness—the Economist is only concerned with the extraneous causes of supply in relation to demand. He does not deny that the purchaser has a preference. He is aware of arguments that can be adduced to prove that preference is the ultimate cause of demand; and that degree of usefulness is the ultimate factor in deciding preference. But these arguments only lead into a cul-de-sac, for the reason that they permit of no quantitative analysis. Whereas supply and demand are ascertainable and definite. Hence the Economist can only deal with exchange value.

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3.—'VALUE' AND 'PRICE'

The reader has almost certainly been in the habit of using the terms 'value' and 'price' indiscriminately as expressing the same thing; and he will probably feel inclined to describe an attempt to discriminate between them as sheer pedantry. Yet it should not be difficult to convince him that there are two distinct sets of facts, which must be expressed by different names if our deductions are not to go hopelessly astray. Think of it in terms of barter. Wheat and rye, *e.g.*, will vary in the rates of their exchange for each other according to the season's yield of the respective products. You would then say that one has risen in value and the other has fallen. But suppose that there has been a bad season, and that all farm produce has suffered *equally*. There would be a diminished supply all round; but so long as the *proportions* have not been altered, their relative values to each other would manifestly remain as before, unless there is a change in demand.

Most obviously, a rise or fall in value involves a 'comparison'; and it would clearly be absurd to say that all commodities have risen or fallen against other simultaneously. But it can easily be assumed that there has been a decrease or an increase in the supply of just one particular commodity, while the supply of all the rest remained constant. In the former case, it could be said that there is a general fall in the values of all other commodities *in relation to that one*; and in the latter case, there is a general rise in values *in relation to that one*.

Very well. When that commodity happens to be given the quality of money—the power to purchase all things indiscriminately—then there can be a rise or fall all round in the rate at which all commodities will exchange for that one which functions as money; just in proportion as its supply is increased or decreased without a corresponding increase or decrease in production. It is still a ratio of exchange; but it is a ratio of all things contra money, instead of a ratio *between* all things one against the other. So to

distinguish the two, we call one 'value' and the other 'price.' There can be—there often is—an all round rise or fall in prices—things against money—but there positively cannot be an all round rise or fall in values. Such a statement would be quite meaningless. The indiscriminate use of these terms has been the cause of much confusion of thought. Unfortunately, the science of Economics is a chronic sufferer from indiscriminate use of terms.

4.—A UNIT OF EQUIVALENCE

We can now see that, unlike a unit of length, weight or capacity, which must be something tangible and fixed, a unit of value is merely a symbol, the hypothetical X, or Figure 1, from which you work out relations of quantities one to the other. The most fitting term for it is to call it a 'Unit of Equivalence,' or common denominator. We can easily conceive a primitive market place in which all products offered to be bartered are sorted out in heaps which will indiscriminately exchange for each other

—of course, each heap being larger or smaller than others in proportion as it is more or less valuable. Very well. You can divide each heap into two, or just double the size of each heap, and yet they would still remain Units of Equivalence. From each such unit you could compute values by multiples or fractions, as the case may be. The unit of value, then, need not be anything tangible, fixed, or assumed to be of some specified dimension. It merely expresses a numerical ratio, not a concrete reality.

5.—NO ONE INVENTED MONEY

Money, as we know, has passed through three distinct stages, and is now well on the road towards reverting to its first stage. It began as a credit record registered on a token of no commodity value. Later, some commodity gradually assumed the character of money. No one ever really invented money—like Topsy, it 'growed.' We have called commodity money a 'pawn-shop' system. This is much more than a mere

figure of speech. The primitive tribesman who laid by a stock of cowrie shells, having in view that he could more readily exchange these for whatever things he may want than he could the product in which he was specialising, had not the remotest notion that he was hoarding up what will prove to be the accepted medium of exchange. It was to him just a 'pledge' more readily disposed of than, say, the mats and baskets which he was engaged in producing as a means of livelihood. When the tribe was finally glutted with shells, and few or no one cared to take them in exchange for other things, some other much sought-after commodity took the place of the shells. It was a very long time before men came to realise the meaning of money; and by that time, money was an accomplished fact, without anybody ever having thought the matter out. And so man kept blundering on throughout the ages. System after system was tried, and each broke down in turn. No one had made the discovery, and very few have done so to this very day, that the principle of money is a most simple one

indeed—that each piece of true money must be a 'Certificate of Delivery'—a 'True Credit.'

In course of time, the discovery of silver provided a substance which was more suitable to function as money than any commodity hitherto employed for that purpose. In many Eastern countries silver is preferred to gold as money to this very day. Even amongst Western nations silver constituted a money 'standard' to within a very recent period. But the great majority of Western nations—at any rate, the 'governing' majority—have now come to the conclusion that gold has many advantages over silver to serve as money. The two principal advantages are that its relative scarcity and high cost of production make it less liable than silver to violent fluctuations; as also less expensive to transport and more convenient to handle, since much commodity value is contained within a small compass.

6.—BIMETALLISM

To the bulk of people of the present generation Bimetallism stands for just one of the many currency fads with which the world has been afflicted from time immemorial—the speculation of a few impractical dreamers. Yet Bimetallism has been the currency system of the civilised world for five hundred years; and was a 'burning' question during the last century almost to its very end. It is really quite amusing to read the scathing denunciation of the theory of Bimetallism by Mr H. D. MacLeod, M.A.

'There is not the faintest shadow of the shade of the ghost of the *nth* differential co-efficient of a pin's point of evidence in favour of the contention of the Bimetallists. It is absolute ZERO.'

And much more to the same effect, in language quite as vigorous and emphatic. There have been many world-conferences held to

consider the subject; parliamentary debates and Reports galore, and no end of literature. The subject is, of course, far too big to be discussed adequately in these pages; and, moreover, in the present state of the world's opinion, it has ceased to be of any practical importance. Yet, a treatise on Money and Credit, however limited in scope, would scarcely be complete without a brief outline of the salient points at issue.

The Bimetallists' contention is that the two metals, gold and silver, should both be minted freely to any extent, the respective coins to be of specified weight and fineness, and should both circulate freely as money in a certain fixed ratio to each other—*e.g.*, 1 of gold to 15 of silver. Now, it has been shown by Sir Thomas Gresham as far back as 1560, and proved incontestably by long experience, that whenever there are in being two sorts of money, whether of the same substance or of two different substances, one of which is of inferior commodity value to the other, the inferior money drives the superior money completely out of circulation. Thus, if a King or

Government emits an issue of, what is called, ' debased ' gold money—that is, coins of less weight or fineness than that already in circulation—making the debased money legal tender for the same values as the full-weight money, the debased money drives the coins of higher commodity value entirely out of circulation. Or if both silver and gold circulate at a fixed legal ratio corresponding to their market ratio of exchange for each other, and then an increase in the supply of either metal reduces its market value in relation to the other metal—at the same time, of course, reducing its exchange value in relation to commodities in general—the metal which is now of depreciated value will soon become the sole money in circulation.

7.—INFERIOR MONEY DRIVES OUT SUPERIOR MONEY

The money of superior commodity value disappears from circulation for the very obvious reason that debtors will not pay their debts in the more expensive metal if

they can legally do so in the less expensive one. The more expensive money is either hoarded, or is melted down for use as plate, jewellery, and so forth. No legally fixed ratio can possibly prevent this so long as either metal can be taken to the Mint and coined free of charge. For the same reason, the debased money displaces the 'sound' money of the same metal. I think it is admitted by the Bimetallists that no single State could possibly escape this consequence of fluctuations in the value of the metals, even if legal restrictions could be devised to prevent the melting down of coin, since the superior money would simply make its way abroad, if not openly, then by 'underground' ways. But their calculation is that if all nations adopted Bimetallism, and all of them fixed a common ratio of value between the two metals, then the market values would of necessity conform to the legally fixed ratio, whatever the variations in supply or demand. That would, perhaps, hold good if the metals were used for currency purposes only; but since they are also used largely for other purposes, there

seems to be no reason whatever in support of this contention. We are asked to suppose that the economic law of values being governed by supply in relation to demand will be abrogated in this case just because something has been written down on pieces of paper!

We then have the ingenious contention that the very rush for the cheaper metal wherewith to pay debts and effect purchases would so increase the demand for that metal and diminish the demand for the other that the market ratio governed by supply in relation to demand would soon be brought into conformity with the legally fixed ratio. Without stopping to examine this contention on merits, the Monometallist might well reply: 'Thank you for nothing.' It is the fluctuations that cause the mischief; and it is of little consolation to be told that nature is always striving to reach an equilibrium, and that in the long run it will get there or thereabouts. Granted that even with a one-metal standard, and that one the least liable to violent variations in supply, fluctuations in the level of prices cannot be

escaped; but with two metals as money standards competing against each other, industry would be in a constant state of ferment. Debtors and creditors would do their best to outwit each other; traders would be chary of making contracts far in advance; production would be hampered and checked.

But what is it exactly that the Bimetallists propose to gain by making both metals legal-tender money to an unlimited amount? We have seen that, so long as a section of the community had not yet learned to avail itself of the use of banking credits, a certain proportion of the total of currency instruments of all kinds—gold, silver, bronze, and paper credit documents—employed in effecting the total of exchanges of things and services must consist of legal-tender money. The workman must receive his wages in something which cannot be rejected as payment for his purchases; and the small vender or shopkeeper who has no banking account must be paid for his wares in something which he knows to be legal payment for the stock he wants. The proportion required will depend upon the extent to

which the habit of, and facilities for, banking had been developed. Thus, Great Britain will require a smaller proportion of legal tender to the total of exchanges than, *e.g.*, a country like Turkey or Bulgaria. Is it, then, the contention of the Bimetallists that there is at all times, and in all countries, a deficiency of the requisite proportion of legal-tender money? I do not think so. As I understand it, it is just a plea for more money on the general grounds of human impecuniosity. Mankind have to go short of things because of the want of money wherewith to get things. It is just the old, fatal delusion over again that, to satisfy human needs and desires, it is only necessary to create a plenitude of money. The gold or silver, as the case may be, which is not minted into money would be there just the same in bullion; and this, one would suppose, could be exchanged for other things at whatever may be the exchange value of the metal. But no, this will not do; one cannot change a thing for other things which, perhaps, are not in existence. You have only to turn the metal into money when all

other things would spring into being out of the *ewigkeit*!

Now, the strangest part of this controversy is that not one of the opponents of Bimetallism has a word to say in contravention of this delusion. All of them are apparently agreed that the creation of more money must add to human prosperity, the opposition being merely to this particular method of increasing the stock of money. If nature's supply of certain metals suitable for coining could only be kept constant, so that an invariable ratio of values could be maintained between them, man could be made happy and prosperous beyond conception by an unlimited minting, not alone of gold and silver, but also of platinum, nickel, aluminium, copper, and some other metals! Even Mr MacLeod, the author of *The Theory of Credit*, whose fierce indictment of Bimetallism may be gauged from the quotation given above, has nothing to say in opposition to the main purpose which Bimetallism is intended to accomplish. Of Mr MacLeod's *Theory of Credit* I shall have something to say before I have done.

Bimetallism is now, however, practically out of the running; and in its place is arising a muddle-headed conception which claims to advocate a 'credit' currency, but of which the reality would be a 'debit' currency. Compared with this colossal delusion, Bimetallism is the quintessence of sweet reasonableness.

CHAPTER VI

CHAPTER VI

I.—WHAT IS MEANT BY EXCHANGE AT PAR?

No two countries have the same money unit. In international trading, the seller generally contracts for payment in the money of his own country. Let us suppose for the moment that all foreign payments are made in gold. A London merchant having an account to settle in New York would have to purchase dollars for sovereigns, wherewith to pay his debt. What would be the rate of exchange of sovereigns for dollars? Would the price of dollars in sovereigns fluctuate with variations in the demand for dollars? Supposing that Great Britain had bought more from the United States than the United States had bought from Britain, so that the demand for dollars exceeds the demand for sovereigns, would the dollar rise in price against the sovereign?

I believe this is the general impression; but it is quite erroneous.

The reader has probably read the statement that the 'par' between sovereigns and dollars is £1 to $4.86. What exactly is meant by that? It means that this is the equivalent of the gold-contents of the respective standard coins. Our sovereign consists of 123¼ grains of gold, eleven-twelfths fine, and the dollar consists of 25.8 grains, nine-tenths fine; hence their relative gold values is purely a matter of calculation. Quite so, the reader may say, other conditions being equal, gold will exchange for gold quantity for quantity; but the coin is a manufactured article, and its price should, therefore, vary with variation in demand. So it would but for the fact that, in both countries, *minting is free of charge and compulsory*—that is to say that any one is entitled to take gold to the Mint and demand that it be converted into the coinage of the country. In this country, the Bank of England is bound by law to buy gold at its par value—*i.e.*, £3 17*s.* 10½*d.* per ounce—less 1½*d.* commission. (Of course, it cannot get it now

for that price in notes, but of this anon.) But even where a State bank is not bound to buy it, dealers will always exchange foreign gold for a nominal commission, since it is merely a matter of waiting for the Mint to turn it into legal-tender coin.

2.—WHAT IS MEANT BY 'GOLD POINTS'?

But though the gold money of two gold-standard countries must always exchange at par, there is the cost of transporting the gold to be taken into account. Hence merchants never pay their foreign debts in gold if by any means that can be accomplished by the medium of paper documents, even by paying a premium for them, so long as that does not exceed the cost of sending gold (assuming that gold is available). In normal times, therefore, the premium will fluctuate within the compass of the cost of transporting gold. This is what is meant by the expression of 'gold points.' When merchants on this side have to pay a premium for paper on the United States, we say that the 'exchange' with the United

States is 'against us'; and when merchants on the other side have to pay a premium for paper on London, we say that the exchange is 'in our favour.'

3.—BILLS OF EXCHANGE

It may be taken for granted that most people have, at any rate, a rudimentary knowledge of a Bill of Exchange. It has for long been the practice in trading to allow the buyer some period of time, to enable him to dispose of some or all of his purchase, before being called upon to pay for the goods. The common practice is for the seller to draw a Bill on the buyer, the following being an example of an inland bill (as distinct from a foreign bill, which is of a more complicated character):—

Sixty days from date pay to me or my order the sum of one hundred pounds sterling for value received.

JAMES BROWN.

To JOHN SMITH, Esq.,
1, Commerce St., E.C.

John Smith then writes across the bill: 'Accepted, payable at ——,' and signs his name. Or, perhaps, he arranges with his banker to 'accept' bills on his behalf. In some countries, such bills commonly pass through many hands, each holder in turn endorsing it by signing his name on the back of it, and are finally presented by the last holder for payment by the 'acceptor' at the place named. But in Great Britain and some other commercial centres such bills, if drawn or accepted by firms of repute, are generally 'bought' by bankers and Discount Houses; and it is a recognised convention that, once such a bill has got into a banker's portfolio, it is not passed on, or, as it is called, re-discounted. Such a proceeding would be deemed to be a reflection on the good repute of the acceptor and drawer of the bill. The expression of 'buying' a bill is another mere convention, for it is not a real purchase in the ordinary sense. If the 'acceptor' fails to meet it, the holder can claim payment from the 'drawer,' or from an endorser, if there is one. In effect, the bill is simply discounted.

The advantage of this system is that, while the buyer gets time to realise before he has to pay, the seller can, nevertheless, get his money, less some small commission, from banker or Discount House. A glance at any bank's balance sheet will show that bankers deal in bills very extensively.

4.—INTERNATIONAL TRADING

International trading is carried on almost wholly by means of such bills, much more so than in home trading. It is in the matter of these bills that London has for long been the centre of the world's banking. Merchants all over the world enter into arrangements with London bankers to 'accept' bills on their behalf. Thus, a manufacturer or merchant in China, Japan, or other distant country, who sells goods, *e.g.*, to some one in America, instead of drawing a bill on the purchaser, will draw it on a banker in London. Apart from the question of personal trustworthiness, the seller in China or Japan knows by experience

that a bill on London is much more negotiable, and at a smaller discount, than a bill on any other part of the world. Owing to the fact that Great Britain has for long been the largest exporter to all parts of the world, and that so many people have to pay accounts in Britain, a bill on London is in ready demand almost everywhere. And so the practice has gradually grown up that London has become the 'accepting' centre for the world's commerce. But for the invention of Bills of Exchange, and the wonderful organisation of the banking business, international trading would be terribly hampered and wasteful. When it is remembered that practically all trading buyers expect to be given time before they are called upon to pay their accounts, but that yet many sellers are not in a position to sink their capital for such periods, it will be readily realised that international trading could not possibly have developed to the extent that it has without the intermediation of bankers, manipulated by means of paper documents. Let us illustrate.

5.—FOREIGN BILLS OF EXCHANGE

A and B are two London merchants, of whom the former has bought goods from C in New York, and the latter has sold goods to D in the same city. For the purpose of this illustration, we will suppose that the two transactions are for equal amounts, and that the accounts fall due at the same time. If A paid C and D paid B in gold, there would be two consignments of gold passing each other across the Atlantic, involving two costs for freight and insurance. But why incur this expense? A single paper document sent by post, plus a trifling stamp duty, can be made to clear both accounts.

Thus, *e.g.*, B, on this side, draws a bill on D, his debtor in New York. A, who has to pay C, then buys the bill from B, and so B gets paid for the goods he sold to D in New York by his compatriot in London. A then posts the document to C in New York, who then collects the amount from D in the same city. In fact, A buys D's

debt from B, and then transfers it to C, his creditor in New York. Or the operation can be done the other way about—that is, C, in New York, draws on A, and sells the bill to D, who sends it to B in London. Not a single coin need cross the Atlantic either way.

But let us look a little deeper into the matter. Both A, who buys the bill from B on this side, and D, who pays C on the other side, pay by cheques which are very rarely actually cashed. So much of bankers' credits are transferred from one account to another—just a debit entry in one, and a credit entry in the other. And these cross entries may go on for years without either party ever drawing cash for paying trading debts. All these are squared by transference of bits of paper, and by entries of figures in books. In the final analysis, it is simply an exchange of goods and services, whether in trading between people of the same country, or between people of different countries. In the above example we see that the goods sent by C to A are exchanged for those sent by B to D. Except

in the case of two countries one of which is lending to, and the other is borrowing from, the other, there must be an equation in values between exports and imports in the long run, else one of them will become bankrupt. Unless a country owns a gold mine, it can only get what it wants from other countries by giving up an equivalent in what its own soil and people are capable of producing. However, the theory of international trading does not come directly within the scope of our investigation. We are here only concerned to understand the part that money and credit plays in effecting the world's exchanges of goods and services.

Our example supposed facilities which, in practice, do not often occur. Thus, we supposed that the debts of A to C and D to B corresponded in amount and matured on the same date. The squaring of the two accounts would then be a very simple matter, which the parties concerned could easily arrange without the intervention of a banker. But in practice, the intermediation of bankers is invariably in requisition in the

settling of accounts in international trading. To begin with, B will probably have drawn on D at the time he made his sale and have disposed of his bill to his banker or broker. A probably knows nothing of B's dealings with New York; and when he wants a bill on that city, he goes for it to the recognised dealers in bills. All bankers have Agents, or, as they are commonly called, Correspondents, in all the principal business centres; who make it their business to act as intermediaries, and to adjust amounts, dates, and other necessary details. As we shall see in a moment, bankers are often called upon to perform other important services besides the mere selling of bills which they have previously bought of merchants, drawn for sales of goods to foreign buyers.

6.—CAUSES OF VARIATIONS IN EXCHANGES

Now, it will be quite obvious that the sales and purchases between any two countries will rarely be in a state of equilibrium. Though in the long run exports and imports

must balance each other (counting the rendering of services as exports), if both are to remain solvent, it will be manifest that there must be frequent fluctuations in the balances of indebtedness. To begin with, there are the inevitable seasonal fluctuations. Thus, at certain seasons of the year Virginia will be exporting raw cotton heavily to Great Britain, and Canada will be exporting grain. These will be balanced, and, perhaps, overtaken, during other times of the year, by imports of machinery, farming implements, and manufactured goods generally. Temporary causes of many kinds, including merchants' miscalculations and over-speculation, will turn the balance this way and that. It follows that during the period when Britain is importing more from the United States than it is exporting thereto, there will be a shortage in London of bills on the United States. As a natural consequence, bills on the United States will be at a premium, since buyers of bills will be bidding against each other to secure what bills there are. But so long as gold can be sent in payment of the excess of debts over

credits, the premium cannot exceed the cost of sending gold.

Are we, therefore, to conclude that, to whatever extent there happens to be a shortage of mercantile bills in the market, the balance must be settled in gold? Here is where the bankers step in. If the banker has not a bill to sell you, he will sell you a 'Draft' on his Agent or Correspondent in the creditor country. In effect, he instructs his Agent on the other side to pay your account out of funds provided for such purposes. There are countries which deliberately demand gold in payment of their products. Thus, at certain periods of the year, gold is regularly consigned from London to Egypt, and some American States; but these are the exceptions. As a general rule, bankers manage to square accounts between different countries by the medium of paper credit documents. Merchants naturally seek to pay their accounts in the least expensive medium.

Variations in the rate of exchange, then, express the rate of premium or discount, as the case may be, which bankers charge

for paper credit documents of one country on another. The main cause of these variations is purely a question of supply and demand; but other psychological factors also operate. There is not a flat rate for all classes of paper. A long dated bill (*i.e.*, one not maturing for some considerable time) will be quoted at less than a short dated bill; and the rate will also depend upon the standing and reputation of acceptor and drawer. They are actually quoted as 'first-class bills' and 'second-class bills.' The prospect of a country going to war, or, in the case of a small or unsettled country, the fear of a general slump or bankruptcy, will naturally depress the price of its paper credits. As Mr George Clare aptly puts it (*The A.B.C. of Exchanges*, p. 79), 'A rate of exchange is the condensed effect of a variety of facts and forces which are too numerous and too complex to admit of direct appraisement; and, in the majority of cases, the best explanation we can give of an exchange movement is to pick out one prominent cause, and to hazard a guess at the others.'

CHAPTER VII

LEGISLATIVE LIBRARY
ONTARIO

CHAPTER VII

I.—GOLD AS A STABILISER OF EXCHANGES

Our analysis of the course of foreign exchanges had as its basis the condition precedent that, in the last resort, the debtor country was in a position to pay the balance in gold. Many of my readers will probably see in this a positive confirmation of their inherited faith in the virtue of gold to cure all economic ills. The foreign merchant, they will say, wants to be paid in gold; and the Bill of Exchange only meets the case because it is still a claim for gold on another person. So long as the gold is there, exchanges will only fluctuate within the limits of the 'gold points'; but when a debtor country is unable to pay in gold, even though it is able and willing to pay in goods, the exchanges may go against it to any extent. Gold will keep the exchanges stable to within a fraction of par just because

the real demand is to be paid in gold, and the substitutes are mere makeshifts for satisfying this demand in a roundabout way.

But this assumption clearly misses the essential point. It may be that an individual creditor desires to hoard gold; it may be that the country of which he is a member is in need of gold, either to replenish a depleted reserve, or when a country is newly adopting a gold-standard. But whether the creditor wants gold or not, if gold is the standard money of his country, he is not in a position to demand anything else, unless he has gone back to barter. His contract is for payment in the money of his country, and he cannot go behind that. As between two countries one of which has a gold standard and the other a silver standard, the exchanges will, in addition to other causes, also fluctuate as a consequence of fluctuations in the respective values of the two metals. But as between two countries having the same standard, an offer to pay in the legal-tender money of the creditor's country ends the matter, even when that legal-tender money consists of paper notes. In reality, the

creditor wants to be paid in an instrument, no matter of what kind, which possesses the purchasing capacity bargained for; and it is only when that instrument, not being legal-tender in the creditor's country, has depreciated in purchasing capacity that a premium is demanded proportionate to the depreciation. At this point I may usefully reprint an article of mine contributed to the *Westminster Gazette*.

2.—PROTECTION AGAINST LOW EXCHANGES

For many years Mr Moreton Frewen has been hammering away at the proposition that a nation prospers by depreciating its currency; but hitherto without producing any visible effect. Though our classic *Reviews* welcomed his contributions, his arguments and demonstrations created no observable stir; his readers remained strangely apathetic. They have been educated into believing that a falling exchange was a national evil, and a restoration to par an unmistakable sign of returning prosperity. Hence the contrary view was

looked upon with much scepticism, even when critics were not prepared to controvert the arguments. They merely said, 'How clever!'—and passed on the other side.

But at long last a section of the public seems to have been suddenly converted to his views, without so much as a wry face or bodily quiver at shaking off a cherished conviction. The Government of to-day, with its huge mechanical majority, is vouching for the accuracy of Mr Frewen's doctrine. To stop the nations whose exchanges are at a very low ebb from prospering at our expense we must protect ourselves against their sending us goods which they can produce and sell so much cheaper than we can, not as a result of greater efficiency in any respect, but merely as a consequence of their low exchanges. To read any sense into this contention we must assume that those who sell them the raw materials are so stupid that they fail to take cognisance of the disparity in exchange so that the price which they receive in the depreciated money shall be the equivalent of the price which they would demand in the money of

their own countries. There is only one other element, apart from superior producing capacity, which may enable nations with a low exchange to reap an advantage from that in costs; but with this I shall deal presently.

The subject of exchanges is a perfect riddle to the man in the street, and is largely misconceived even by the well-informed. Several elements enter into it, which must be analysed with some care. Russia, Austria, and Poland are extreme cases in a category apart. They have next to nothing to export, and their bankruptcy and repudiation is always impending or expected. The inflation of their currencies is gigantic and continuous. In Russia a mountain of roubles has to be given for a piece of bread which formerly cost one kopeck. In the case of Germany the fear of bankruptcy is not wholly absent, and inflation is still proceeding. The case of ourselves and the United States, where the fear of bankruptcy is wholly absent and inflation has ceased, is the simplest, presenting only two elements.

The small daily fluctuations are due to what may be called the Stock Exchange element, where we can see a complete parallel. The 'dealer' is not in the least concerned in the inherent value of the stocks or shares in his 'market.' He quotes a buying and selling price, the difference being his gain, and is only concerned to balance his books at the end of the day, so as to pocket the differences. If there is an excess of buyers he lowers his buying price and raises the selling price, and vice-versa. It is the punters who make the fluctuations.

Dealing in exchanges is known as 'arbitrage,' and the method is somewhat more complicated, though of the same nature. The dealers are in constant telegraphic touch with their agents in all principal centres of the world, and when there is a difference in rates they buy in the cheaper market on one side and sell in the dearer on the other side. When buying and selling 'forward' they have to estimate probabilities and take risks; but, even so, they endeavour to keep the sides balanced. They

are not concerned with inherent values; it is still the punters who make the fluctuations.

But behind these fluctuations there is an ultimate cause. In a word, the rise or fall stands for the difference in the level of prices. In two gold-standard countries, in both of which minting is free of charge, the standard moneys must obviously be exchangeable for each other at their respective gold contents. But when gold cannot be sent in settlement of an adverse trade balance, the debtor can only offer to pay in notes. But the legal-tender notes of one country are, of course, no more than bits of paper in another country. The question that rises to one's mind is, since these notes have no money validity at all abroad, why have they any exchange value whatever? The answer is, surely, quite manifest. Though the notes are not money in the creditor country, they are legal tender in the debtor country. Suppose that the currency inflation has been greater in this country than in the United States, and that the level of prices has on that account risen by 28 per cent. more here than it has risen

there. Then any merchant in the United States dealing in goods which he buys from us will gladly buy our paper at a discount of 30 per cent., since he will thereby gain 2 per cent. when he buys here and pays for the goods in those notes. That is what ultimately governs the rate of exchange, when the fear of bankruptcy and further inflation is eliminated. We see the proof of this at the present moment, when, with falling prices, our exchange rate is rapidly rising.

Now, two main items enter into cost of production, and the cost of production necessarily governs the selling price in the long run. The bigger item is the wages of labour, and the next is the cost of materials (ultimately also the wages of labour). The suggestion that a country with a low exchange gains in the cost of materials as a consequence of that fact may be dismissed as a stupid fallacy. But, in the past, employers were able to economise considerably, and for long periods, in the cost of wages, as a direct consequence of a depreciated currency. In countries where trade-unions

are weak or non-existent, employers are still in a position to gain thereby for considerable periods; and in all countries labour is victimised for some short time. But in all Western countries, where trade-unions are strong and well organised, this factor in reduced costs has ceased to operate for any appreciable period. Labour insists upon an increase in money wages commensurate to its reduced purchasing capacity.

Mr Moreton Frewen has, I doubt not, correctly stated the facts, but he has omitted to put the accent on the true cause—that the manufacturers were enabled to develop an export trade by shamefully robbing the workers. I am not in a position to say positively to what extent this factor operates in Germany to-day, but one example within my knowledge will throw some light on the matter. I bought a German-made piano some twenty-five years ago, the trade price of which was M.310. I should like to say, by the way, that it is still a musical instrument of exceptional excellence in every way. The trade price of this class of instrument is now M.8000 to M.9000,

with celluloid instead of ivory keys (not including duty).* Producers and traders faced with a slump will be driven to sell at a loss, as is now happening at home; but this is only a phase, not a governing principle in production. The tendency to an equilibrium is nature's universal law; things tend to exchange for each other at the labour costs expended in their production.

Where a nation is constrained by poverty to submit to a lower scale of subsistence, it may be selling its special products at a cheaper rate than would be demanded by a nation subsisting on a higher scale; but this is an old problem which has nothing to do with exchanges, and cannot be discussed in this connection. To protect ourselves against these we should have to exclude goods from all the world except those coming from the United States! But the contention that we must protect ourselves against the supposed advantages of a depressed exchange is the most egregious nonsense imaginable. All nations with a depressed exchange rate are striving their utmost to correct it as fast as possible;

*When this was written the mark stood at about 450 to the £.

though the need for it is highly questionable. What the world wants is stability, not any particular monetary par.

The last sentence in the above article needs further elucidation. This, I think, is made clear in the following article which I contributed to the same journal. We shall then have practically concluded the analytical part of our inquiry. I then propose to make a concise Epitome of the main points of our investigation; after which I shall submit some suggestions on the future of Currency.

3.—CURRENCY AND INFLATION

Has our currency been inflated? Granting that it has, does it, therefore, remain inflated for all time unless the added currency is withdrawn from circulation? If an adequate elucidation is not possible in a single article, I can, at any rate, suggest the lines of thought for the reader to follow up. A word by way of definition. The Right Hon. R. McKenna prefers to restrict the meaning of currency to legal-tender money;

and to designate the total of instruments constituting purchasing capacity by the term 'spending power.' I ask the reader to understand me to mean by 'currency' what Mr McKenna means by 'spending power.'

The doubt entertained by some as to the fact of inflation probably arises mainly from limiting the meaning of 'currency' to legal-tender money. Some time ago a writer in the *Round Table* argued that there really was no inflation, since the Currency Notes were readily absorbed by the public almost as fast as they were being issued, proving that they supplied a genuine need, and were by no means redundant. This sort of argument comes strangely from a contributor to the *Round Table*, and is only another proof of how the subject of currency operates as a 'smoke-screen' to obscure the mental vision of otherwise clear thinkers.

We know that at a certain period in industrial evolution it was found necessary to adopt a composite currency of metallic money diluted with paper credit instruments; and how the paper instruments gradually

but surely ousted the metal until the proportion of the former to the latter was something like 200 to 1. If our banking system could be so organised as to embrace all members of the community, including the wage-earners, scarcely any other currency than the cheque would be required. As it is, a certain proportion of legal-tender is required for the payment of wages and for retail purchases.

If we grant that the banks have been issuing loans beyond the true credits at their disposal, thus creating spurious claims and increasing the effective demand without a corresponding increase in production, it is obvious that the equilibrium between demand and supply will be destroyed. The inevitable result is a rise in prices until a new equilibrium is established. Now, inasmuch as the legal-tender money must bear some definite proportion to the total of currency, it follows that with an inflation of credit currency, or what might be called 'Bank money,' there will be a genuine demand for a proportionate increase of legal-tender, made necessary by inflated prices. Instead, then, of the ready

absorption of the Currency Notes proving that there was no inflation, it is, on the contrary, unmistakable proof of inflation. The writer might have urged that the rising prices were solely due to lessened production; instead of which he is saying: 'There cannot be too much legal-tender money, else people would not be wanting it.' Of course there is not; and the reason for that is simply the proportion necessary to meet the increased prices, as a consequence of the inflation of the bank currency.

THREE FACTORS

The present abnormal rise in prices is the result of three factors operating to the same end—*i.e.*, lessened production, inflation of currency, and what is now commonly known as 'profiteering,' but which the student of economics has long known as the consequence of monopoly, or quasi-monopoly. The law governing prices of monopoly goods is quite different from that governing prices under free competition, which is a question of supply in relation to

demand. When the primal necessaries of life fall into the hands of monopolists there is practically no limit to their rise in prices short of being absolutely prohibitive. I am not prepared to assign the proportions of the rise due to the respective causes; but to doubt the fact of inflation is to shut one's eyes to the glaringly obvious.

Here are just a few figures given by Mr McKenna. Since 1914 bank deposits have risen from £1,070,000,000 to £2,300,000,000. This immense increase is not the result of added production, but purely that of bank loans, principally direct to the Government, but also to private people for lending to the Government, simply created by book entries, and constituting additional demands on things, though there has been no such increase in production. As the cheques were drawn by the Government for goods at enormously enhanced prices, they were paid into the banks and showed as increased deposits. The legal-tender money, from a total of £203,000,000, has grown to £584,000,000. Thus the total of currency —what Mr McKenna calls 'spending

power'—has increased by the huge sum of £1,495,000,000, or 125 per cent.

The question now arises: Should our currency be deflated by redeeming the Currency Notes, and withdrawing them from circulation? Let us try to visualise more vividly the issues involved in this problem by means of a mental image.

THE SELF-CONTAINED ISLAND

Once upon a time there was a self-contained island which had neither the need nor the desire to trade with the rest of the world. In the course of the year the inhabitants were producing 2000 million units of products (approximately our pre-war income in terms of the pound sterling); and to avoid needless complications, we will assume that both the population and producing capacity remained constant. They, of course, required some currency instrument wherewith to effect the exchanges of those products. The quantity of units of currency required will depend upon what economists call 'the velocity of circulation' of the

currency—in plain language, the quickness of the turnover. We may picture a huge national warehouse, or market, where the goods to be sold are handed in on one side, in exchange for currency, and are taken out for consumption on the other side by returning the currency. Let us, then, say that there was a turnover of fifty times in the course of the year. There would thus be required 40 million units of money.

It happened that a gold mine was discovered on the Island which yielded exactly 4000 million grains of gold, and then completely gave out. The notched-stick currency hitherto used being much too uncertain and troublesome, owing to counterfeiting, the nation decided to use the whole of that gold as currency. The unit of currency was, therefore, made to consist of 100 grains (our sovereign contains 123¼ grains).

But on one unlucky day, some one discovered a new gold mine, and that yielded another 4000 million grains. The nation was jubilant. Here is a heap of more money

wherewith to get things. But, lo and behold! as the gold got into circulation prices began to rise and in the end the 8000 million grains could get no more of things than the 4000 million grains got before. Had they thought the matter out they would have seen that this was quite inevitable. Of course the new currency could get no more of things—the things were not there to be got, since no more was being produced.

The process of transition from the old to the new level of prices caused no end of mischief. Creditors who sold before the inflation were victimised. Debtors were on velvet—they could pay their debts with just half the units of products which they received. Production was disorganised, since producers were uncertain of the trend of prices, and utterly at a loss to trace the cause. Wage earners were mulcted of their rightful share; and those with fixed money incomes were brought near to destitution.

When prices finally reached their new level, and a fresh equilibrium was established, matters were gradually adjusted to

the new conditions. Money wages and fixed incomes were just doubled; producers settled down to work in reliance upon a return of stability. Creditors had suffered, and debtors had gained; but that was too late to mend. The islanders decided to accept the accomplished fact; but never more to run the hazard of another such an upset, by prohibiting the working of any other gold mine that might be discovered. Their currency unit had shrunk to half its previous purchasing capacity; but since the gold was already there and no further labour had to be wasted to get it, it mattered not whether the unit of product costs 100 or 200 grains. With the establishment of the new equilibrium there was no longer any inflation. The new level had been found, and stability was restored. They were simply using a smaller money unit.

But it so happened that during this very time that inflation was at its highest the State had launched the important enterprises of road-making and the construction of harbours for its fishing fleet. To do this

it had to borrow of its citizens. The bond-holders, very cute business men, hit upon a clever scheme. Though loans are expressed in terms of money, they said, that is only the financial symbolism. What we really lent was part of what we had been producing. The workers on the roads and harbours must have food, clothing, and shelter, to say nothing of beer and 'baccy. But whereas before the inflation, when one of us gave up, for example, a pair of boots to be worn by the road-mender, he was credited with 100 grains of gold, since the inflation has taken place we received for the same pair of boots a promise of 200 grains, and interest added. This is all very well on paper; but in actual fact, when we come to spend these 200 grains, we get no more of things for them than we used to get for 100 grains. True, we paid our workmen in the same depreciated grains; but that is nobody's business but our own.

Let us, then, raise a loud and unanimous cry that our currency had been tampered with—that it had been reduced in value—that it had been debased—that our reputation

as a solvent and honourable nation had been stained and besmirched. Let us demand that the currency be deflated, by withdrawing the added 4000 million grains from circulation—make them into horse-shoes or throw them into the sea. Then shall we wax and grow fat. When the State pays us the interest or repays the loan, each 200 grains will buy twice as much as it does now, or as it did when we lent it! But we must not say that—mum is the word.

The end of the story is not yet. Perhaps the reader may help to shape it.

LEGISLATIVE LIBRARY ONTARIO

CHAPTER VIII

CHAPTER VIII

I.—AN EPITOME

I MUST now epitomise concisely the essential points of the arguments advanced in the preceding pages, before I attempt constructive suggestions on the future of currency.

1. When primitive man passes the stage of being a self-contained economic unit he starts by bartering the product of his own labour for the products of the labour of others. There is thus set up an evolutionary process of specialisation of industries. Labour becomes more productive by the acquired skill and the economy of effort, consequent on the division of occupations.

2. But with the advance of specialisation, barter becomes increasingly difficult. So in course of time personal credit gradually takes the place of 'simultaneous swopping.' There is as yet no money in any sense. Promises for the return of what is agreed

between the parties as a fair equivalent are stipulated for in definitely named things.

3. As a mere aid to memory some sort of instrument had to be devised to record the indebtedness of the tribesmen one to the other. This took the form of making notches on sticks. The unsophisticated savage had not yet learned the gentle art of cheating. The barter had then become 'deferred.'

4. Occasionally the article stipulated for as a return ceased to be as much an object of desire as some other article which the creditor desired more keenly. Some genius then hit upon the idea of passing the claim which he held on his neighbour, recorded on a notched stick, on to a third party, in exchange for that which he desired more. In course of time the passing on of such claims from one to another became more frequent, and then quite general. The notched sticks, in actual fact, got into circulation as currency. It was the beginning of money.

5. An important development then took place. The credit, or its converse, debt, from being personal between two parties,

became reciprocal or general credit. It was a claim on any member of the tribe. In effect, the currency instrument bore the impress that the holder has, by self, or proxy, given up something for the consumption of others, and is entitled to an equivalent in return. From 'direct' or 'deferred,' the barter became 'roundabout.'

6. But another exceedingly important development took place. A currency instrument, no matter what it consists of, must necessarily stand for a *unit of equivalence*. Suppose that one notch, or a notch made in a particular way, customarily stood for a given measure of corn. When the notched stick became the currency of the tribe, it is evident that not every holder wanted corn. How, then, is he to know how much of something else he is to get for it? Manifestly, he will expect as much of something else as is commonly exchanged for that measure of corn. When he goes to market he will say that he wants a notch's worth of barley, milk, or eggs.

7. But human cupidity presently overtakes the instinctive tribal ethics. The

notched stick is easily counterfeited; and the currency system then breaks down completely. Man was then driven to evolve a currency instrument of commodity value. Beginning with ornamental shells of several kinds, it goes through a long list of substances, until it finally settles on the two metals, silver and gold. In essence, it is a 'pawn-shop' system. So long as a commodity currency is necessary, silver and gold are certainly the most suitable for the purpose.

8. With the institution of a commodity currency the troubles break out in a fresh place. While man practised barter he always got what he considered a fair equivalent of what he gave up. The notched stick currency, by involving a lapse of time between the giving up and the receiving of something else in return, inevitably introduced an element of uncertainty. The commodity which he mostly needs may have become scarce, so that he will get less of it than he could have got by barter on the spot. On the other hand, it may have become more abundant, so that he will get more. Or

it may be that while he gets less of one thing he gets more of another. In the long run, then, it may be said that a 'compensating balance' roughly adjusted the differences. So long as this currency did not suffer from increase by counterfeiting, there was only the uncertainty of fluctuations in the production of commodities. But with the establishment of a commodity currency, a second element of uncertainty entered into the equation, by the fluctuations in nature's supply of that particular commodity. There is no 'compensating balance' to rectify an increase in nature's supply of the substance serving as money. All commodities must rise in price—unless the increase in producing capacity has kept exact pace with the increase in the money substance.

9. A stage was reached in producing capacity and international trading when an exclusively metallic currency was no longer possible. Indeed, the increasing capacity to produce wealth, largely fostered by international commerce, would have been arrested at an early stage but for the resumption, in effect, of the notched-stick system.

Very timidly at first, the metal currency was weakly diluted with paper credit instruments. Gradually but steadily, these instruments ousted the use of metallic money until the proportions were strikingly reversed. Before the war the proportion of paper credits functioning as the medium of exchange to gold currency was something like 200 to 1. That was only made possible by the concurrent evolution of the art of banking. For the last seven years gold has practically gone entirely out of circulation in this country.

10. But the poor currency Humpty could never be kept out of trouble for long together. Propped up against falling on one side of the wall, he presently started tumbling over on the other side. While commodity money is inevitably subject to fluctuations from nature's supply of that commodity, paper credit currency is dangerously liable to much worse fluctuations by the arbitrary action of Governments and banks.

11. Various causes were constantly in operation to contribute to Humpty's sufferings and downfall. Quack physicians, utterly

unable to diagnose the correct nature of his malady, were constantly prescribing useless and dangerous remedies. When money became firmly established, mankind began to see a topsy-turvy image of the economic reality; and that image has not yet been eradicated. They ceased to see it as an instrument whereby they were enabled to substitute 'roundabout' for direct barter. Money became to them the sum and substance of wealth, from which all other wealth flowed automatically as a matter of course. They lived in an atmosphere of money, as Professor Irving Fisher puts it. Whenever nature turned into an unkind foster-mother, by yielding less than usual of things needed to sustain life, mankind, in their fatuity, clamoured for the manufacture of more money. They wanted more tickets written out for prizes out of the lucky tub, without having first put the prizes in the tub.

12. In this they were greatly encouraged by the ludicrous misuse of a word—the term 'credit.' When a person borrows, we say that he has got 'credit'; and when

a person lends, we also say that he holds a 'credit.' 'Credit' and 'credibility' have got inextricably mixed up mentally, to the utter confusion of clear thinking. As a result, a school of self-styled Currency Reformers has sprung up, who argue that, since credits really function as money, the quantity of money should only be limited by the amount of good security on offer by borrowers; or, if the money is issued by the Government, by the collective security of the nation's assets as a whole. In fact, the money should be based on 'credibility,' not on credit. The bulk of it would then be a 'debit' currency, not a credit currency.

13. Certainly, every unit of a true currency is a 'credit.' The notched-stick, if not counterfeited, stands as a credit for something given up to be consumed by others. When, in place of that, it is a gold coin, it is still a credit for something given up. Though a commodity, it is only held as a pledge. That may make the return more certain; but its essential character is still a token of credit. If the notched-stick,

or the paper note, fails to secure a return, or the return of such an equivalent as was contemplated, then the instrument has failed to function, either wholly or partly; and we may then be driven to using a commodity currency solely, or even to revert to direct barter, as is the case at the present moment in some parts of the world.

14. It remains, then, to discover why a given currency fails, and how the currency Humpty is at long last to be perched up securely, and kept from tumbling on this side of the wall or that. I maintain that it will not fail—granting, of course, honest administration and national solvency—so long as every currency unit is a *true* credit, not merely 'credibility.' You must think of your currency tool as a 'Certificate of Delivery,' or as a 'Bill of Lading,' if that will make the thought stand out more clearly. The Bill of Lading is a valid demand by the holder on the cargo in the ship. The captain must not give it up without the presentation of the bill; the cargo is actually there. It is idle to manufacture a Bill of Lading on a cargo that has no

existence! Currency is an instrument for effecting barter in a roundabout way. A, who holds a claim for something given up, may transfer it to his banker, and the banker may transfer it on loan to B. It is still a true credit claim for something that has been given up, and is in the market to be claimed. But it is preposterous to maintain that one can manufacture a demand token though it stands for nothing that has been given up, because the one who manufactures it, or for whom it is manufactured by a Government or bank, has good security. The things which he offers as security are not given up and placed in the market to be claimed by others. The result is that claims are made on things which, at *current prices*, are, in effect, not there to be claimed. What happens is a recasting of prices to establish a new equilibrium between the units of things on sale and the now excessive units of currency. This is what we call 'currency inflation.' In actual fact, it is nothing less than the imposition of a tax on the producing community.

15. We have seen that the essential quality

of a currency instrument is, that it shall consist of a *true* credit. If our banking system could be so organised as to embrace all classes, including the weekly wage earners, very little indeed of any other form of currency than the cheque would be required. But under hitherto prevailing conditions it was necessary to have a certain proportion of legal-tender money, which was compounded of metal coins and paper notes. Before the war all notes were promises to pay gold; but our present currency notes bear no such promise. By the Bank Act of 1844 the Bank of England was compelled to keep a gold reserve of 60 per cent. against its note issue, which was gradually reduced to 40 per cent. Banks could pay either in gold or Bank of England notes; but, since the notes were convertible on demand, both cheques and notes were, in effect, payable in gold on demand. Needless to say, not more than 10 per cent. of the possible demand could ever have been met. The fiction was kept up in reliance upon the knowledge taught by experience that men do not want gold except in case

of panic. Whenever such panic did set in the Government had to step in and save the system from collapsing by forbidding the payment of gold.

16. Banks were lending only from 60 to 70 per cent. of the credits held by them on deposit and current accounts, and the great bulk of that was lent on such securities as were saleable on the Stock Exchange practically at sight. The rest of their assets (less till money) were invested in Government securities. But this saleability also depends upon the expectation that men in a body will not demand gold. If they did the 'market' for the securities would tumble to pieces like a house of cards. When we remember that in 1913 over £16,000,000,000 were cleared at the Bankers' Clearing Houses we shall realise how infinitesimal is the amount of gold or notes used in proportion to the volume of exchanges effected by nothing more than entries of figures in books—in effect, by per contra accounts.

17. We can also realise the enormous power for mischief which lies in the hands

of Governments and banks, and the two acting in conjunction, in creating spurious credits. Governments can pass laws enabling them to issue legal-tender notes at discretion, or can authorise the banks to do so. Under promises of protection against panic 'runs,' Governments can induce banks to issue loans to them in excess of the true credits at their commands. There is all the difference in the world between the transference of a true credit from one person to another and the creation of fictitious credits which stand for nothing that has been given up for others to consume.

18. Honest financing is simply the management and administration of the surplus products created by the world's producers. Economic progress is wholly dependent on saving. Before any other industry than food production can possibly come into being, the food producers must be producing more than they are consuming, which being saved, may then be placed at the disposal of others, who can then be spared from food production and employed in producing other things of necessity and comfort. When

these also save, it becomes possible to detach some workers for producing luxuries, without going short of necessaries and comforts. But above all, economic advance depends upon the utilisation of the surplus for creating true capital—*i.e.*, tools, implements, and machinery, by which human labour is made vastly more productive. The creators of the surpluses receive credit tokens entitling them to a return for what they have placed in the 'market' to be consumed by others. These credits are deposited with bankers, who, in addition to mere book-keeping, and the balancing of per contra accounts, transfer these credits on loan to others, thus setting the production of capital goods and of other industries in motion, out of which the returns are made to the original credit holders. The borrowers get claims on available surpluses, and themselves then create surpluses, the claims on which are handed to the lenders. But the surpluses must be there to be claimed. This is 'honest' financing. The creation of fictitious credits is dishonest financing, however good the security may be.

19. The issue of such fictitious credits, whether in the form of legal-tender notes or of bank credits in excess of the true credits in hand, constitute what we know as currency inflation. The first visible result is a gradual rise in prices, until a new equilibrium is established. The invisible results are that creditors lose to the extent of the rise in prices, while debtors gain; the community is taxed to the extent of the inflation; and a general disturbance of industry, owing to the variability in the purchasing capacity of the currency unit.

20. The general notion is that when a currency is inflated it remains inflated for all time. But this is not so. A currency is only inflated during the period of transition to the new-price level. We shall grasp this fully by reverting to the primitive notched-stick unit. While it was yet merely a record of personal debt, we may suppose that it stood for some recognised measure of corn. When the notched-sticks later function as currency, it is evident that not every holder wants corn. Clearly each holder will expect to get for it as much of any other commodity

as is usually given in exchange for that measure of corn. It becomes *a unit of equivalence*. The original fixing of the unit was purely conventional; and so long as no fictitious units are added it will remain perfectly invariable. If production is increased there will be an automatic increase, in proportion, of currency units. But supposing that the notched-stick originally stood for a measure of oats, which commonly exchanges for only one half of a measure of corn. It would still function invariably, though the unit would be smaller. Nothing of consequence is lost by using two sticks, or making two notches, in place of one. But supposing after the unit had become firmly fixed as the equivalent of a measure of corn, the Government steps in and arbitrarily doubles the number of notched-sticks in circulation, the monetary unit would begin to drop in purchasing capacity until it had finally found an equilibrium by purchasing only one-half of a measure of corn, or its equivalent. During the process of transition the mischief is being done. The Government gets a gradually

diminishing revenue; the creditor gets a progressively smaller return for what he gave. When the equilibrium is reached and provided there are no further additions, all that happens afterwards is that the exchanges are effected by the medium of a smaller conventional unit—the currency has ceased to be inflated.

2.—CLEARING THE GROUND

Students of science have always been conscious of the inadequacy of word-symbols to define thoughts with sufficient accuracy to escape frequent misconceptions. The need of framing a concise and self-contained formula to express the unity governing apparently disconnected phenomena leaves it all the more exposed to being misconceived, by reason of the omission of qualifying details. When Herbert Spencer invented the formula of *The Survival of the Fittest*, it was almost immediately adopted as much preferable to Darwin's formula of *Natural Selection*. But while Darwin's formula has

the disadvantage of an apparent 'personification' of Nature, endowing it, as it were, with a preconceived aim, Spencer's formula is open to another serious misconception. Most people interpret it to mean the survival of the 'ideally' fit; but it means nothing of the kind. It simply postulates the self-evident truth that, in the constant battle with surroundings and conditions, those individuals or types which possess qualities that enable them to resist more effectually the assaults of environment will survive, as against those who are less advantageously equipped. In a sewage infected area, the sewer rat will be more fit to survive than any other living organism; but this does not make the rat more 'ideally' fit from a preconceived standpoint. Given a change of conditions and environment, qualities which formerly conduced to survival may prove the very agents of extinction. Of this the history of the evolution of species, both as recorded in geologic formations and revealed by more recent transmutations, gives incontestable proof.

Sociology and Economics are branches of

the great science of Evolution. A system of government, of currency, of trading, or of any other social adjustment does not come into being in a day; it evolves by slow degrees, in conformity to prevailing conditions and environment. A system of credit currency depends for its efficiency upon the credits being made readily transferable, and the maintenance of confidence in the fulfilment of the obligations incurred. Such a system could not have grown up without the intermediation of an elaborate and cleverly organised banking system, which had gradually evolved in the course of centuries. This has now almost completely superseded the 'pawn-shop' system of currency. The purely 'commodity' money had first to give way to a compromise of a currency compounded mainly of metallic money weakly diluted with paper promises to pay. By slow degrees, the proportions of the compound have undergone a progressive change, the credit element gradually, but surely, ousting the metallic element, until there was little of it left. The stage had long since been reached when it could

truly be said that the compound consisted mainly of paper credits weakly diluted with metallic money. But recently, so far as our internal currency is concerned, we have seen an almost complete disappearance of our chief metallic money. The conditions, in short, have radically changed. The fact, therefore, that at an earlier stage in human evolution gold and silver were the substances most fitted to survive as money can be no criterion of their fitness to survive under completely changed conditions. The question before us, then, is: Have we reached a stage when the small dilution can be safely dispensed with? Of the economic gain to mankind, if practicable, there can be no question.

It is commonly taken for granted that bankers are the most competent persons to advise the nation on problems of currency. But I deliberately maintain that, with few exceptions, they are the last persons in the world to offer a true solution, as compared with those who have made a study of the subject from the purely scientific standpoint, unhampered by banking practice and

traditions. Mr Arthur Kitson and his fellow members of the Banking Reform League maintain that the bankers' self-interest is too intimately bound up with the gold standard to constitute them safe guides in the matter. I cannot say honestly that this is an extravagant allegation, however strenuously it may be repudiated. Self-interest plays a large part in human affairs, and even bankers are probably not quite free from such unworthy motives. But it is not at all necessary to insist upon that to make good the proposition that bankers are least likely to see the right solution of the problem. In a long established system, evolved and elaborated during centuries, the endless details cluster round, and adjust themselves to, the central core upon which the system depends for its vitality. In course of time, those actually engaged in the business cease to question the soundness of the core upon which the system is built up. They take that for granted. To the banker, the gold standard is axiomatic. He could no more doubt that than that two and two make four. This is made quite evident in the Reports of the Committee

on Currency and Foreign Exchanges. Granting the inviolability of the gold standard, the conclusions are in the main quite sound. One cannot eat the cake and have it too. A gold standard without gold is worse than *Hamlet* without the Ghost.

Thus much by way of clearing the ground before entering upon the last stage of our inquiry as to the future of currency. The human mind is prone to hang on tenaciously to any system hallowed by age and custom. The pseudo-scientific will uphold it on the score that it has proved its fitness by survival; while the man in the street will put it more colloquially that if there had been anything seriously wrong with it it would have collapsed long since. In actual fact, the world has never yet had a stable currency; it had been doing little else than stumble and totter from its infancy onward. Long before the birth of scientific analysis, man had already become deeply obsessed by the belief that money is the sum and substance of all wealth; and he has never yet been able to shake off that belief. He has been taught to call money 'purchasing power,'

as if its purchasing capacity were a property inherent in its substance.

It is only of recent years that a true science of currency has begun to emerge from the ashes of accumulated failures. At last the currency Humpty has had the greatest fall of his chequered life; and the bankers are trying to bring up all the King's horses and men to put Humpty together again. But the Bankers are the last physicians in the world to diagnose his disease correctly; and their tinkering will be of no avail. Now, if ever, is the time to give the shattered Humpty a decent burial, and to enthrone a healthy and robust Humpty on the wall in his place.

LEGISLATIVE LIBRARY ONTARIO

CHAPTER IX

CHAPTER IX

CONCLUSION

Let us now sum up in a few condensed paragraphs what it is that we want a currency to do; what are its inherent difficulties, shortcomings, and limitations; can these be entirely escaped; and if not, what system will best serve to reduce these to the lowest practicable minimum. The reader is aware that we use the term 'currency' to mean all instruments which function as purchasing capacity, or, which comes to the same thing, in settling debts. The term 'money' is frequently limited in conception to legal-tender only; but this limitation, useful, perhaps, as a mere matter of classification, covers only a small item in the problem before us. Legal-tender is now only supplemental to banking credits, forms but an insignificant fraction of the total, and tends to become still less. The problem before

us is: Is it still necessary to maintain a gold basis upon which the huge super-structure of credit is supposed to rest? and if yes, how are we to avoid the fluctuations in purchasing capacity, both as a result of an increase or decrease in nature's yield of the metal, and that of an arbitrary increase or decrease in the volume of paper credits? In a word, how are we to maintain monetary STABILITY, which is so essential to industrial life and progress?

Variations in the level of prices as a consequence of fluctuations in the supply of gold are, at any rate, limited by nature; whereas paper credit documents can be multiplied arbitrarily, to an unlimited extent. Now, were it a question of choosing between an exclusively gold currency (bar small change) and an exclusively paper currency, the argument in favour of gold, though far from conclusive, would have considerable validity. But we have no such choice; a reversion to exclusively gold money is simply unthinkable. A mixed currency, as we know by ample experience, does not escape the danger of credit inflation. It was

thought at one time that the principle of 'convertibility' would obviate that danger. And so it would if it could possibly be made real and effective; but, in the very nature of the case, it never was—it never could be—anything but a mere palliative—a 'fair-weather friend.' Complete convertibility under all possible conditions is both physically impossible and entirely nonsensical. There is not a fraction of the gold in existence that would be required if all nations kept reserves equal to the amounts of credit claims in circulation, and supposing there were so much gold, it would be manifest folly to keep it in reserve, and thus increase the cost of administration, when it then might just as well be in circulation as money in place of the credit currencies. Since, then, reserves are designed to meet only a fractional proportion of the possible demand, States are bound to protect themselves against a monetary collapse, by reserving the power to abrogate the right to demand gold, at discretion, in the event of an actual or probable panic run. But having taken away with one hand what they gave with

the other hand, there is no longer any protection against inflation. It is in times of national stress that inflation of currency generally takes place.

It may be urged that the question of currency is largely a psychological problem —that it is a matter upon which sentiment, not logic, has the last word. In barter the equivalents change hands simultaneously, and there the matter ends. But currency is a promise to repay an equivalent at some future date; and, in the case of legal-tender paper, is not even a personal promise, but only a general demand upon dealers who are offering goods for sale. It is all very well to say that the dealer is bound by law to accept the paper as payment; but if he has no confidence in it, he will simply tell you that he has not the goods to sell, unless, law or no law, he is assured of being paid in gold. Though the undertaking to convert into gold on demand relies upon the presumption that very little of that will be demanded in normal times, yet it is sufficient to maintain confidence in the paper currency, which otherwise might fail

of acceptability. People must be impressed with the belief that there is gold for them when they want it, even though it is largely a fiction, if the paper is to function without hitch or breakdown.

Well, our experience during the last seven years has completely falsified this contention. Though gold has practically gone entirely out of circulation, our paper currency has functioned wholly without hitch. In so far as the rise in prices is due to inflation, it is a question of quantity pure and simple. The tendency to an equilibrium between the total of the media functioning as demands on goods and the total of goods offered for sale must always operate whatever the substance of the media employed. To escape fluctuation in price levels, and to positively ensure that the currency will function without hitch, it is only necessary that each currency unit shall be a TRUE CREDIT—a 'Certificate of Delivery'—a just demand to the return of an equivalent for what has been given up to be consumed by others. Banking and financing must consist solely in the transference of true credits—

claims on surplus wealth actually in being—not in the creation of fictitious credits. Provided this condition is secured, currency and production will always be in exact equilibrium; and the acceptability of the currency will never be in doubt or question.

There is a sense in which it may be said that men buy, sell, and exchange only credits, or 'rights.' Social consent is a condition precedent to security of possession. One 'owns' a piece of land, *e.g.*, only in the sense that society has granted him the legal title, or 'right,' to its exclusive use and the future enjoyment of its potential fertility. Without collective protection, possession would always go to the strong and powerful. It may be said that, in actual fact, that is exactly what takes place under the guise of legal right, framed by the strong and powerful to meet their own ends; but, even so, it remains true that it is the right or claim to future enjoyment that one buys or sells. Without such 'right' it would be a matter of a mere brute scramble. Credits are valid demands on future production; and it is these credits, or rights,

which men buy, sell, and exchange. In his *Theory of Credit*, Mr H. D. MacLeod presents this case with a wealth of elaboration —some would say, perhaps, with tiresome iteration. He examines it logically, juridically, and historically, and views it from every possible angle. It is sufficient for our purpose to realise that credits are claims on future production; and that if they are to function as currency, each unit must be a rightful demand to the return of an equivalent for what has been given up to be consumed by others. Stocks and Shares are credits in quite a different sense: they are not claims to the return of equivalents on demand, but are merely contracts for the payment of a specified annual interest, or a share in the earnings of a specified undertaking. A currency instrument must be a 'medium' of barter in the true sense, differing only from it in that, instead of the equivalents changing hands simultaneously, it is a 'right' to demand a full return at some future date. 'Roundabout' barter then takes the place of direct barter. As we have said, a currency instrument

that does not stand for a 'Certificate of Delivery' is either a tax or a fraud.

I hold that the world has now completely outgrown the need and usefulness of commodity money. That has served a necessary purpose in the childhood and adolescence of the social organism. The marvellous evolution of the world's banking system has grown up as a direct consequence of the imperative need of dispensing with the use of commodity money. I hold that the case against the gold standard is complete in every detail. Nevertheless, the suggestion that this country should be the first, and perhaps, the only one for many years yet, to completely demonetise gold is not a practical proposition. While so many other countries adhere to the gold standards, we are not in a position to entirely discard the use of gold as a medium of payment in international trading. Nay, as soon as it is possible, it is still necessary for us to re-establish our position as the 'free gold market' of the world. Our country has for long been the principal banking and 'accepting' centre of the civilised world,

mainly because 'Bills' on London were so largely in demand all over the world; but also because merchants abroad knew that they could always get gold here whenever they wanted it, so long as monetary conditions remained normal. This reputation we cannot as yet afford to lose. It has constituted an appreciable proportion of our national income. But the conditions must be considerably modified if the stability of price levels is to be maintained.

I am afraid I shall disappoint many of my readers when I say that I am not prepared to submit a cut and dried scheme complete in every detail; but only to throw out general indications and suggestions. If the reasoning which I have submitted—following in the wake of such eminent authorities as Professor Irving Fisher and some others—is accepted as sound, the matter must be taken in hand by a Committee of practical experts, who will have to examine the subject from every possible angle, and make themselves responsible for a detailed scheme and its necessary organisation. The subject is too big; and I am no more than

a student outside the inner ring of practical banking. If my reasoning falls short of carrying conviction, I shall be grateful if those who disagree will write and tell me wherein they think I am wrong. Those who agree will, I trust, take steps to create a public opinion in favour of the necessary changes.

Our national currency should consist of paper documents : containing the necessary proportion of legal-tender notes, but mainly of banking credits, both notes and banking credits being issued strictly against true deposits. The bankers should devise a method of book-keeping which would not show the loans which they grant to clients as so much of fictitious deposits. Under the present method, when a bank grants a loan to one of its clients of, *e.g.*, £1000, it consists, as a general rule, of a credit entry for that amount in that client's ledger account, upon which he is enabled to draw by cheque. If the bank's balance sheet happens to be made up on the following day, the bank's apparent deposits would be swollen by that £1000. No notes or credits must be issued against such fictitious deposits.

A Currency Board would have to be appointed by the Government to see that this principle is carried out in its integrity. Provided it is so carried out, prices would remain stable—there would always be an equilibrium between currency and goods on offer for currency.

But this does not necessitate that gold should go entirely out of circulation. The Bank of England—probably in some closer connection with the State than at present—must keep a reserve of gold, principally for payment to foreign creditors, whenever necessary. But there would be two important changes. The Bank would not be compelled by law to pay gold on demand; but would do so in practice so long as the demand was normal. And the gold would not be coined in denominations, as it is now, but would be merely stamped with the number of grain contents, as a State guarantee of weight and fineness. I suggest that the two principal coins should consist respectively of 60 and 120 grains; and that they be brought into conformity with foreign gold money, by being nine-tenths fine,

instead of eleven-twelfths. *The gold would then be exchanged for legal-tender paper at the market price of gold*, whatever it happens to be at the time the demand is made.

An oz. 'troy' contains 480 grains; so that when the price of gold in notes is £6 per ounce, our paper pound would equal 80 grains (at the time of writing, the price is about £5 11*s*.). There is no reason in the wide world why we should now attempt to restore the note to its former equivalent of 123¼ grains of gold. In so far as the rise in the level of prices is due to currency inflation, the mischief was done during the period of transition. A new equilibrium has now been established; and all it amounts to is that we are now using a smaller money unit. Well, why not? All other countries are using much smaller units than ours. The attempt at deflation is already causing much more mischief than it can possibly cure. Indeed, it can cure nothing except that of restoring the incomes of those who derive it from a fixed money interest. On the other hand, it enormously increases our liabilities, both in interest

and in the repayment of the capital, to the nation's creditors whose loans were made in depreciated currency. What we want is STABILITY of price level, no matter what unit of computation is employed; and that would be secured by the use of the currency of which every unit stood for a true credit —a Certificate of Delivery. So long as we had a gold reserve to meet adverse balances in foreign trading, the exchanges against us could only fluctuate within the limits of the 'gold points.' But the ultimate cause of exchange rates is a question of price levels, granting that a country produces goods to export wherewith to pay for its imports. Needing no gold for home circulation as currency, changes in its world distribution would affect us very little, if at all.

The Currency Board must have full control of the issue of legal-tender notes. As a general principle, that should be kept down to the lowest possible minimum; if for no other reason, because it offers temptations to hoarding, which is the deadly enemy of economic progress. The practice of banking could be developed much more

widely than it is at present. The Post Office Savings Bank, for example, could, with a little alteration, be turned into a National People's Bank, receiving and paying by cheque. The State must establish some closer connection with, and control of, the banking business, so that the banks may be put in a position to lend practically the whole of the true credits at their disposal. 'What is saved must be consumed.'

The proposal made by Professor Irving Fisher for stabilising the dollar differs in one important respect from that outlined above. In place of the Treasury redeeming notes for gold at the current market price of gold, he proposes to make it contingent upon the level of prices as shown by the 'Index numbers.' There are several systems of index numbers, all of them fairly reliable in showing the percentage of rise or fall in prices; though, perhaps, none of them achieve absolute accuracy.

Thus, the prices of a number of staple commodities during some given year, considered to be normal, are taken as the basis of calculation, and are indexed as standing

for 100. A rise or fall in the prices of these commodities at any time are lumped together, and an average is struck, showing the percentage of the general rise or fall. The grain contents of the gold dollar of that year is taken at 25.8, its present fixed weight. Then, if prices have risen by, say, 5 per cent., that much in grains would be added to the exchange ratio of gold for paper dollars; and if prices have fallen by 5 per cent., that much less of grains would be given by the Treasury in exchange for paper dollars. Official notification would be published on the first day of each month, giving the exchange rate of gold for paper for the coming month, based on the prices disclosed by the index number. Of course, gold coins would not be minted as at present, but merely discs stamped with the grain contents. The Treasury would also be prepared to buy gold at the same rate. Thus the purchasing capacity of the nominal dollar would always remain stable.

If I may be allowed a criticism, I would suggest that this might give rise to a considerable deal of gambling, in anticipation

of rises or falls between one month and the other. All the same, I sincerely hope that Professor Fisher will succeed in inducing his countrymen to make the experiment. Any move in the direction of currency stability is a distinct gain. It is something to have it recognised that currency stability is what the world needs. Public opinion on this matter is far more advanced in the United States than it is in this country.

These are the bare outlines, which will require careful elaboration and discussion. I submit that a drastic reform in the world's currency systems is a matter of vital necessity. I commend the matter to my readers' careful and painstaking thought: and their active participation in a movement to bring about the necessary changes. For untold ages the world has been groping its way through a maze of ignorance in its effort to discover a stable currency system. It kept on taking various tentative steps in the right direction; but from time to time there came upheavals which toppled the unsafe structure back into chaos. The time is now ripe for a real, scientific reconstruction.

APPENDIXES

APPENDIX I

(The following Article which I contributed to the *Westminster Gazette* bears so closely on the subject in hand that I thought it desirable to reprint it as an Appendix.)

On Profit Making

The story of the island whose inhabitants made their living by doing each other's washing has for ages been the classic satire of industrial futility. But why? Laundrymen do, in fact, earn a livelihood by the profits they make out of doing washing. Why, then, cannot all make profits out of doing each other's washing? An absurd question, you say. If A makes a profit out of B, B out of C, and so on, until finally Z makes it out of A, they are just where they were at the start. Cleanliness is next to godliness; but it would be just as godly

if each did his own washing. It is manifestly the acme of futility to pass a profit round in a circle, and in the end to have accomplished nothing beyond having done the washing. Man does not live on washing alone, any more than he does on bread alone.

But is there any more sense if, in place of passing a profit round for doing the same thing, it is passed round for doing different things? I have made it my business for some very considerable time past to get at the conception of profit-making of as many people as I could induce to listen to me. To each one of them I put it that by making a profit is meant that *the seller gets from the buyer something more than he gives*. In all but a few exceptional instances this meaning of profit-making was granted without a moment's demur. In that case, I continue, the idea that a nation, or the world as a whole, taken collectively, can earn an income by profit-making is a patent absurdity. A can get from B something more than he gives him, in which case A gains at a loss to B. But let A to Z be the

community; each is in turn buyer and seller; then if each gets from the other more than he gives, they are obviously just where they were.

On this there usually follows a look of blank puzzledom. 'That is all very well,' then comes the protest, 'but how is the manufacturer or trader to live unless he can make a profit? There is a catch here somewhere, though I cannot quite place it.'

But occasionally I meet some one, who, in hesitating fashion, objects to my definition —not that he really ever doubted it, but that, scenting an argument, he, with quite a common instinct, declines to be taken at a disadvantage by granting a premise readily. 'What the seller gets in excess of the cost,' he avers, 'is the remuneration for his services.' Quite so, I agree; but in that case there is no profit-making, but simply an exchange of equivalents.

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MAN AND HIS SERVICE

I then proceed to demonstrate that man produces nothing, but only renders services. Nature alone does the producing. All that man can do is to extract, mix, shape, mould, adjust, and transport. One man guides the plough, another follows with a basket and scatters seed in the furrow, while a third simply walks to and fro between field and barn, refilling the baskets as they are emptied. Which of them does the producing? There are hundreds of other services before the grain is matured, prepared, and made available for consumption. Of these transport is one of the most important under present conditions, when the whole world is one economic unit. For purposes of classification it is convenient to distinguish between the extraction and the fashioning of tangible objects of utility, which we commonly call production, and such work as transport, the mental work of organising, co-ordinating, and the work of banking in its many branches, which we

commonly call services. But in reality, all human production consists of services, in other words, of labour, manual or mental, in adapting nature's products to the satisfaction of human needs, and in training the faculties to the performance of the various services.

Hence, in the human sense, all service is production, and vice versa. If, then, we conceive of human production in terms of ideal units, it simply comes to this: that what the seller receives from the buyer in excess of what he calls his prime costs are the equivalent of the units added by him to the product by his personal services—be that what we call distributing, transporting, or the organising of industrial activity. When he gets more than that, it is what we now call profiteering, by which we mean to say that he is taking advantage of his fellows, and gains at their loss. It is, of course, perfectly obvious that some may gain to the loss of others; but it is equally obvious, on analysis, that a nation or the world, taken collectively, cannot possibly procure an income by profit-making in the commonly

accepted sense, any more than it can procure an income by doing each other's washing. It will, perhaps, be said that the service of capital does not fall within this ambit; but this is not so. Granting that the capital is necessary to the industry in question, then it is the means to creating so many units of products. The owner of the capital may be said, if you will, to have rendered service by proxy, as the result of past saving. The point is that, apart from profiteering, men exchange equivalents, and that no collective income can possibly be earned by profit-making.

THE MEANING OF 'PROFIT'

I admit that 'profit' is a convenient term of account, and that I can suggest no other term that will readily take its place. Remuneration or recompense does not quite meet the case. The manufacturer or trader is to some extent a speculator or venturer, and does not always get the return equivalent to his services. Sometimes he

may get something in excess of that, and at others he may be an actual loser. He calls the one his profits and the other his losses. I do not quarrel with the choice of terms; what I want is clear-cut thinking. A nation will prosper economically in proportion as it learns to extract more wealth from nature by increased and better services, but not by each getting from the other more than he gives. Apart from profiteering or speculating, mankind is engaged in exchanging equivalents; and the more they produce the greater the equivalents exchanged. There is more to go round when nature has been induced to yield more. That is where the real profit comes in. Individually one's income will also be in proportion to one's capacity to render services, aided, however, by more or less exclusive access to superior fertility.

But does it really matter whether the incentive to industry is furnished by the desire to obtain an equivalent of the products of one's labour by exchanging with others, or whether it is furnished by a hunt after phantom profits? I say that it matters a

great deal indeed. The notion of profit-making, as old as the invention of money in some form, has made mankind see a topsy-turvy image of the economic reality; and the results of that perverted vision have always been a clog on economic progress. They conceive of industry as a game of Beggar my Neighbour. 'No one can profit,' said Montaigne, 'without damaging some one else.' Workmen cannot be made to realise that wages are a share of the total product, and that if they produce less than they might there is inevitably less to share out.

The bulk of mankind measure prosperity by the volume of exports—not as index to possible imports, but as a means to making profits. When we export we make profits; but when we import it is the foreigner who makes the profits; hence the more we export and the less we import the richer we become. We are to labour and sweat so that the foreigner may consume the products of our labour, and we are to get profits—in money. But what is the money to do for us? Why, of course, to buy

products. But where from? Apparently from what remains at home after we have sent away a huge volume for other nations to consume. In the words of Bernard Shaw, this is indeed the Economics of Bedlam. If there are any profits on balance—which there is no reason to assume, since the foreigner is no fool—it is the imports which are the profits, not the exports.

Despite lip-service to formulas, the Mercantile Theory of Wealth still remains the economic conception of the bulk of mankind; and nothing is doing more to perpetuate it than the prevalent notion of profit-making. It is astounding to me that no economist has so far set himself the task of demolishing this stupid fallacy root and branch. Is there, then, a flaw in my argument? I shall be glad to know if there is.

APPENDIX II

(A Lecture delivered by the author before the Economic Circle of the National Liberal Club, and elsewhere.)

Foreign Exchanges

By way of introduction, I propose to read you a sentence from Mr George Clare's book, *The A.B.C. of Exchanges* :—

'A rate of exchange is the condensed effect of a variety of facts and forces which are too numerous and too complex to admit of direct appraisement; and in the majority of cases, the best explanation we can give of an exchange movement is to pick out one prominent cause, and to hazard a guess at the rest.'

It will console you, ladies and gentlemen, to know that even experts cannot find their

way easily out of this maze; and it will be a consolation to me, insomuch that you will be more indulgent with me if I fail to trace all the operating causes and factors, and to allot to each its true value.

At the outset, let us see if we can discover some general principle which will guide us in our search. One is often asked the question—at any rate, it used to be a familiar question in my student days—What is the difference between Knowledge and Science —where does the one leave off and the other begin? I think the correct answer is that Knowledge becomes Science when a 'Unity' is discovered as the governing cause of apparently isolated phenomena—in other words, a Generalisation, or what we call a Natural Law. By registering certain isolated items of knowledge in connection with the behaviour of substances coming in contact with water, primitive man learns to make a dug-out canoe. When presently he finds that a canoe has became submerged, and in course of time sinks to the bottom, he is puzzled. What he might have called the 'exchange par' between wood and

water is no longer reliable. When in course of time man discovers the unifying principle which we call the Law of Specific Gravity, he not only knows why wood will sink when it is water-logged, but he is enabled to build huge floating ships encased in metal. . . . Is there a similar general Law discoverable as a central cause governing monetary exchanges; and that variations from the general Law are attributable to numerous contributory causes, analogous to the water-logged timber?

I think we shall find this general principle in the well-known scientific formula that 'Nature is always striving to establish an equilibrium.' Correctly applied, this formula furnishes us with a master key to the solution of all economic and currency problems—a veritable Aladdin's lamp, throwing open to us the gates to the vast treasure cave of accurate knowledge. In the eternal clash of nature's boundless forces, bodies of greater energy are radiating that energy to the surrounding bodies of less energy. But this 'striving' must be understood as only a 'tendency,' though a constantly operating

tendency; since disturbing factors are frequently intervening to modify the central cause.

We shall understand this more clearly by reference to a certain matter familiar to students of Economics—the controversy as to what determines value. Says John Stuart Mill: the value of a commodity is determined by the quantity of labour expended in its production—commonly spoken of as the cost of production. Not so, says Professor Stanley Jevons. Value is determined by supply in relation to demand. Now, how is this controversy to be settled? There is no doubt that the immediate or proximate cause of value is supply in relation to demand. If it takes two days to make a table but only one day to make a chair, it does not follow that the maker will always get twice as much for the table as he will for the chair. If he has turned out more tables than are in demand at current prices, he will have to sell them at a reduced price. But behind the proximate cause lies an ultimate cause. Naturally, he will cease to make tables, of which the supply is excessive,

and devote his labour and capital to the production of other articles for which the demand is more brisk. In course of time, the available tables will be bought up, and a new demand will arise, and with that prices will again rise in proportion to the cost of production. Where the fall in demand is prolonged or permanent, capital and labour will gradually forsake that industry and flow into more remunerative industries. In the long run, the ultimate cause will correct the proximate cause. The tendency is always to the establishment of an equilibrium in the exchanges of the products of equal labour efforts. With this key in our possession, we can now approach our subject with greater confidence.

I propose to deal primarily with the rate of exchange between ourselves and the United States; for the reason that, in this case, what I have called the Central Principle has throughout been almost the sole factor, modified but very slightly by subsidiary causes. I think I may as well make my plunge at once, and raise your surprise and, perhaps, even disgust at what will seem to

you a manifest absurdity, by saying straight out that, within a very little, the exchange between this country and the United States has always been at par, both during and since the war. I think I can see the blank look in your faces. What! when the 'pound' exchanges only for the equivalent in dollars of as little as 14*s*.! And you say that it has always been at par! Well, have patience with me; and if I do not make my statement good, tell me of it when I have concluded.

It is a curious fact that many thousands of people who had not the most elementary knowledge of Economics or of the principles of currency were always ready to tell you that the price of gold in this country was fixed by law. Indeed, it seems that the less people knew about currency the more they were ready to tell you all about it. Now, there is as much sense in the statement about the fixed price of gold as there would be if one were to say that the price of a dozen beans is—another dozen beans! Price is the rate of the exchange of things for money. It would be obviously absurd to quote the price of a given heap of money in terms of

another heap of money of exactly the same quantity and kind. All that the legislature did was to make the Bank of England give the exact equivalent of coined gold for gold in bullion, less 1½*d.* in the ounce commission. As it takes some grains over an ounce to mint four sovereigns, £3 17*s* 10½*d.* is the exact equivalent of an ounce of gold. But it would make very little difference if the Bank of England were not bound to exchange gold in coin for bullion. Minting in this country is both free and compulsory; it is just a matter of waiting your turn. Other bankers would, therefore, be prepared to do the waiting for a nominal commission.

Well, now, what do we mean by par in the exchanges between different countries? Par simply means 'equality.' But how equality? We say that the par between sterling and dollars is 1 to 4.86. Well, 1 and 4.86 don't exactly sound equal. Where, then, does the equality come in? Why, of course, in the gold contents of the respective coinages. The British sovereign consists of 123¼ grains, and the dollar (as part of the Eagle) consists of 25.8 grains.

For the sake of simplicity, let us say that the sovereign holds 125 grains and the dollar 25 grains. How does one make the smaller unit equal the larger unit? Why, of course, by multiplying the smaller unit until you get the equality. Thus $25 \times 5 = 125$. There is nothing mysterious or difficult about that.

We will suppose that a debtor in this country to a merchant in the United States had to pay in gold in pre-war days. The United States merchant contracts for payment in dollars, the money of his country; so the British debtor has to buy dollars for sovereigns. Well, the dollar is a manufactured article. Would not, then, its price fluctuate against sovereigns with variation in demand? Perhaps it might but for the fact that minting is also free and compulsory in the United States; so that it can only be a question of a nominal commission.

But accounts between different countries were not commonly paid in gold. I must take it for granted that you are all familiar with the elements of payments by Bills of Exchange—it would take too long to give

an exposition in detail. Suffice it to say that a debtor, named Smith, who owes an account to Franklin on the other side, buys a Bill which Jones holds for goods supplied to Lincoln on the other side. He sends that Bill to Franklin, who collects the amount from Lincoln in his own country; just as Jones gets paid by Smith, also in his own country. In fact, there has simply been an exchange of goods for goods.

Now, in the long run, a country must be exporting as much as it is importing, unless it is borrowing (for which it pays annual tribute), or is qualifying for bankruptcy. If we could suppose that the exports and imports between two given countries always balance exactly, Bills would carry a merely nominal banker's or broker's commission. But this is not often the case—there are bound to be frequent adverse balances this way and that. Hence the price of Bills fluctuate with variations in supply to demand. When, owing to shortness of supply, we could not buy dollars at 4.86 to the £1 sterling, we said that the exchange was against us. When it was the other way

about, we said that the exchange was in our favour.

But so long as gold was available to be sent in payment in the last resort, the exchange against us could not rise appreciably more than the cost of sending gold. This is what was meant when we said that the exchange could only fluctuate within the 'gold points.' The common impression is that gold will keep the exchanges within the 'gold points' because the creditor demands gold; but this, as we have seen, is quite beside the point. Whether or not the creditor, or his country, is really in need of gold, he is not in a position to exact a higher premium so long as minting is free of charge.

We have now arrived at the crucial stage of our investigation. Since the war, gold must not be sent out of the country by private citizens, assuming we had it to send. When, therefore, a debtor in this country has to buy dollars, he can only offer to pay for them in notes. A quite different position has arisen. Remember, we found the par —the equality—between the monies of the

two countries by a simple calculation of the respective gold contents—since both countries are gold standard. We were saying, in effect, that one bag of beans becomes just as good as another bag if you only fill it up to contain the same quantity as the other, both being of identical quality. But how do you establish equality now? Our currency note is legal tender at home; but it is nothing but a bit of paper in the United States. We say that our pound note is worth so many shillings in the United States. But why is it worth anything at all, since it is not a consumable commodity, and is not legal tender there? How can you make a parity between two things in a country where one of them is legal payment for goods, which the seller is bound by law to accept, and the other is nothing at all?

The answer is that the parity is found in what the Currency Note will buy of goods on this side, where it is legal tender, as compared with the purchasing capacity of the dollar on the other side. In other words, it is a question of the rise in the general level of prices. If, owing to greater currency

inflation on this side than in the United States, prices have soared higher here than there, then the United States merchant trading in goods bought in this country will only buy the currency notes at a discount equal to the difference in the respective rise of prices. The parity is calculated on a new basis; but it is still a parity. Both Professor Irving Fisher and Professor Gustav Cassel have calculated that the fall in the exchange has, in this case, been practically in exact ratio to the difference in the level of prices.

Let me put it to you in another way. By way of illustration, we have taken the British money unit to be 125 grains and the United States unit 25 grains, when we see that the par between them is 5 to 1 (I am supposing the gold to be of equal fineness —which, in fact, they are not). Now, we know that all countries have different money units—Heaven alone knows why!—and that sometimes countries alter their money units. Suppose, then, that Britain has decided to change its gold unit to 75 grains. The par between the two countries would then

obviously be 3 to 1. A smaller unit buys, of course, a less quantity of goods, so that the equilibrium between the two purchasing capacities is now at a different point from what it was before. Now, the effect of currency inflation is that the same nominal quantity of money buys less of goods than it did. It does not matter in the least whether the inflation consists of an additional supply of gold, or of legal-tender notes, or of banking credits (so long as they are accepted as payment). It is the total of units of purchasing capacity that make the inflation or deflation, as the case may be—it is purely a question of relative quantity.

Now, take for illustration a case of two countries, both of which have only paper money. Where would the par be between the two currencies? Obviously, the equality would be found in the purchasing capacity of the respective units. If, then, one country inflates its issue, or inflates it more than the other country, the purchasing capacity of its unit would be lowered, and the par would necessarily be at a new point. But the exchange would still be at par—the equality

established by the altered purchasing capacity. Take the case of our note in comparison with its gold value, if you like. If the price of gold in notes is, say, £6 per ounce, then the pound note stands for exactly 80 grains of gold. Now, it is obvious if 123¼ grains equal $4.86, then 80 grains must equal considerably less than $4.86.

The fact is that we are now using a smaller money unit—smaller, that is, in its purchasing capacity both of gold and of other commodities. Hence the par is at a different point. The more a country inflates the less its unit will purchase, and the lower down will shift its par point in relation to countries which have not inflated, or have inflated less. Apart, then, from other contributing causes, exchange is purely a question of the general level of prices. I trust I have made my case good to your satisfaction that, within a little, the exchanges between ourselves and the United States have always been at par. We see that clearly in the fact that with the continued fall in prices on this side the exchange has been consistently mounting in our favour.

Now as to the contributory causes. I do not think that we are quite reduced to hazarding a mere guess. Our difficulty rather is that, unlike the primary and ultimate cause, we have no definite data from which to deduce the effect assignable to each particular cause. Of course, with continued inflation the exchange rate must continually be falling; but even the mere expectation of further inflation depresses the exchange, and intensifies the gambling element. But there comes into play a most powerful cause which may push an exchange almost down to zero, when there is a reasoned fear that the country may be forced into bankruptcy and repudiation of the currency. When a country is driven into a forced sale of its currency, on a large scale, in exchange for foreign currencies and securities wherewith to pay large foreign debts or indemnities, the exchanges are bound to rise heavily against it regardless of the price level. It is a sheer gamble in 'futures,' with the dice loaded heavily against the gambling buyer. The recent dramatic collapse of the German Exchange is a

result of a combination of these causes; but particularly those of forced sales and the lively fear of a complete breakdown at no very distant date.

A word remains to be said on the question of restoring our exchange par to the pre-war level. This, of course, can only be done by severe deflation; but, with one exception which I shall speak of in a moment, there is absolutely nothing to be gained by that, but, on the contrary, a great deal to lose, both as a direct additional drain on the nation's resources, and in much indirect injury and loss to production and trade during the process of transition.

Even among those who have a fair grasp of the meaning and effect of inflation, there is the misconception that once a currency is inflated it remains inflated for all time —which shows that they have not really mastered the essence of the problem. Let me then put the issue in as plain an illustration as I know how. Suppose a primitive market place where 1000 units of goods are offered for sale; and suppose further that the people who go to that market have

1000 units of money between them, which they mean to lay out in the purchase of goods. What will be the price per unit of goods? To begin with, the merchants do not know how many units of money are on offer; and some of them may get more than one unit of money for a unit of goods; but the merchants whose goods remain unsold (since the money cannot go round at that rate) will obviously begin to compete. It is quite clear then that in course of bargaining, the price will in the long run settle down at a unit of money for a unit of goods.

But suppose that presently the Soviet bethinks itself of printing an extra 1000 units of money, which it pays out to its civil servants, in settling accounts, and so forth. The people who go to the market now have 2000 units of money to spend; but there are still no more than 1000 units of goods to dispose of. Does it need any argument to show that, in the end, prices will adjust themselves to 2 units of money for 1 of goods?

Very well, suppose that the inflation has

stopped there—that no more units of money are to be printed. During the process of transition much mischief was done. Contracts made in terms of the money unit were now paid in a unit depreciated to half its previous purchasing capacity. Workers were paid the same wages in money which could only purchase half the quantity of what they needed. Production got out of gear, since the producers were bewildered by the change in prices which they could not follow, or perhaps even account for.

But at last the new equilibrium was established, when two money units had to be given for what was formerly got for one unit. Stability was established on a new level—in effect, a smaller money unit was being used. The workers demanded and obtained double money wages; the producers and traders, with the return of stability, could again easily adjust their prices and contracts. They had got over their troubles as best they could, and started afresh on a smooth road—there was no use crying over spilt milk.

What sense can there be in now starting the reverse process, and causing the mischief all over again? With deflation, money wages would have to be reduced, and there would be the same outcry, agitation, and strikes. Where previously the creditor lost and the debtor gained, now the debtor would lose and the creditor gain. Production and trade would again be bemuddled, groping for a safe foothold on slippery and changing ground. And in the end nothing will have been gained. Oh, you say, but the money unit will buy more! Well, what of that? If you withdraw 1000 units you make the remaining 1000 units buy more; but there is nothing gained by that. The extra 1000 units are there; an equilibrium between goods and money has been established. You lose nothing worth naming by giving two bits of paper rather than one, since the bits of paper are already there. What is wanted is STABILITY. Having weathered the storm, it is worse than folly to start it over again.

But there is a much greater mischief to be faced by deflation. The bulk of our

national debt has been loaned in the depreciated money. If you restore the purchasing capacity of the money unit by deflation, you will very nearly have doubled the nation's burden in the payment of interest and the repayment of the capital. But what about the exchanges? Well, what is the trouble? Why should we not use a smaller money unit? All other nations use a smaller money unit than ours. If the United States merchant will only give us for the Bradbury the equivalent of 16*s.* in dollars, when he pays it here for goods he will only get 16*s.* worth as compared with the previous purchasing capacity of the pound sterling.

There is the exception I alluded to; and that is the state of those who live on money incomes fixed before the war. I can only say here that if the notion of deflation is given up, and stability on the new level is firmly established, the State should come to their assistance, as it has done in part in the case of landlords.

As to the re-establishment of monetary stability all over the world, that is too big a subject for me to tackle here and now.

I can only say in passing that a world Conference will have to be held, and an agreement come to to stop further inflation, and give the various currency units a stable purchasing capacity. Above all, the German indemnity should be readjusted, and European peoples be put on their feet again to produce and exchange goods and services with the rest of the world. We must realise that industry must be a world co-operation, if we are to get the best out of nature, and not a game of 'Beggar my Neighbour.' Only thus can the world recover from the terrible despond into which it has been plunged by the world war.

NOTE.—A Popular Edition of *The Data of Economics* is now issued at 5s. net, postage 6d.

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